S. Hrg. 100-403

THE MALT BEVERAGE INTERBRAND COMPETITION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST
MONOPOLIES AND BUSINESS RIGHTS

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 567

A BILL TO CLARIFY THE CIRCUMSTANCES UNDER WHICH TERRITORIAL PROVISIONS IN LICENSES TO DISTRIBUTE AND SELL TRADEMARKED MALT BEVERAGE PRODUCTS ARE LAWFUL UNDER THE ANTITRUST LAWS

AUGUST 4, 1987

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THE MALT BEVERAGE INTERBRAND COMPETITION ACT—S. 567

TUESDAY, AUGUST 4, 1987

U.S. Senate,
Subcommittee on Antitrust, Monopolies
and Business Rights,
Committee on the Judiciary,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:30 p.m., in room SD–226, Dirksen Senate Office Building, Hon. Howard Metzenbaum (chairman of the subcommittee) presiding.

Also present: Senators Thurmond, DeConcini, Specter, and Humphrey.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator **Metzenbaum**. I apologize to all of you. Normally, the Democratic caucus concludes at 2:00. Today, we had a distinguished guest, Secretary Shultz, and so I think they were still meeting when Senator DeConcini and I left.

I guess what goes around comes around. The beer bill is back. It is no secret that I believe this bill to give beer wholesalers a special antitrust exemption is the ultimate example of special interest legislation.

Who would benefit from the bill? Beer wholesalers. Who would suffer if the bill were enacted? Consumers, those who like to drink a bottle of beer or two or three. Should the United States Senate pass legislation giving beer wholesalers a special, unjustified exemption from application of the anti-monopoly laws? This Senator thinks absolutely not.

Beer wholesalers already enjoy a State-mandated corner on the distribution of beer in every State of the Nation. Furthermore, 27 States protect beer wholesalers from competition through mandatory exclusive territories for beer distributors, but that does not make it right.

The beer bill would seal beer wholesalers' immunity from competition by exempting them from the Federal antitrust laws. Let us face it. The beer wholesalers want immunity from the antitrust laws so that they will never have to defend themselves against an allegation of anti-competitive behavior, no matter how anti-competitive their conduct may, in fact, be. Then, they could join together to raise prices or to preclude competition.

What is it about beer distributors that entitles them to this special treatment? Nothing, absolutely nothing. I have studied this issue since the soda bottlers' bill was passed in 1980 and I am still looking for one, not two, just one persuasive reason why this bill has merit.

There are only two things that I cannot understand about this bill. First, how can such a worthless piece of legislation keep coming back. Secondly, why does the Congress of the United States have to waste a minute more time considering it, with all due apologies to my distinguished friend and colleague who is the sponsor of the legislation, but I think you might get the impression I do not think much of this legislation. One might read that between the lines.

When you blow away all the suds, there is simply no good reason why the United States Congress should bail out beer wholesalers by passing this bill. This Senator would like to renew a vow I made in each of the last three Congresses. I do not want to pass the beer bill. I do not think we are going to pass the beer bill, and I expect to work against enactment of the beer bill.

My good friend is the author of it. He is a distinguished member of this committee. He certainly is entitled to have a hearing on this legislation even if the Chairman does not think very much of it.

Senator DeConcini, the floor is yours for any responding snide remarks. [Laughter.]

OPENING STATEMENT OF SENATOR DENNIS DeCONCINI

Senator DeConcini. Mr. Chairman, let me answer one of your questions. You asked why are we here. We are here because you, as chairman of this subcommittee, are an eminently fair individual, and you have demonstrated that on a number of pieces of legislation which you and I have differed on and had to vote against, but you have been totally fair and up-front.

We made an arrangement last year on the floor of the Senate that you would give due course and consideration to this bill, which is exactly what you are doing. As far as your comments regarding this bill having no value whatsoever and why should we waste a minute on it, I would only say to my good friend from Ohio, the same reasons we waste so many minutes on bills that you introduce that I think are absolutely worthless that come before my committees that I chair, and I will continue to spend hours and hours on your worthless bills, as I thank you here sincerely for spending today on what you consider my worthless bill. [Laughter.]

Mr. Chairman, seriously, I do thank you for conducting these hearings and holding them, particularly under your strong opposition to the bill. Initially, let me voice this appreciation as a colleague and in the sincerest terms I can.

It is no small accomplishment, with everybody's schedules, and particularly the Senator from Ohio, one of the busiest people in this body, to set this date before the recess and to proceed.

As we begin this hearing, I would like to mention a few preliminary points which may provide some perspective on the issue that is before us today. My first observation is that of the nine Senators serving on this subcommittee, seven represent States which mandate exclusive territories by law.

These States include Ohio, since 1973, represented by our distinguished Chairman; Utah, since 1977, represented by Senator Hatch; New Hampshire, since 1980, by Senator Humphrey; Pennsylvania, since 1980, by Senator Specter; Illinois, since 1983, by Senator Simon; South Carolina, since 1983, by Senator Thurmond; and Alabama, since 1984, by Senator Heflin.

This is significant because under the doctrine of State action immunity, beer wholesalers in these States and in 20 other States which have such laws already are immune from federal antitrust suits insofar as they concern exclusive territories.

In fact, beer wholesalers in those States have greater protection from an antitrust challenge than would be provided under S. 567. This bill requires that there be substantial and effective interbrand competition within a territory before an exemption is applicable. There is no such limitation on the immunity granted under State laws.

For years, opponents of this legislation have contended that passage of the bill would result in an increase in beer prices to the consumer. It seems to me, Mr. Chairman, that if there is any basis at all for opponents' concern about higher prices, there should be evidence of that in the experience of States which have mandatory exclusive territories.

Now, maybe the Chairman knows something about the situation in his home State which I have missed, but the data I have reviewed reaches the opposite conclusion. Prices in the exclusive territory States are not higher, and as we will see, there is some indication that they may actually be lower than in non-exclusive territory States.

Opponents have also claimed that beer prices have increased at a faster rate than other common consumer goods. Yet, if you turn your attention to the chart here to my right and to your left, you will see it is clear that since 1967 beer prices have consistently increased at a slower rate than meat, bread and, for the most part, even milk.

As the graphic shows, beer prices have remained substantially below the Consumer Price Index, which is the darkest line going up the highest part on the chart. This comparison includes the prices of malt beverage products from both exclusive and non-exclusive territory States.

Opponents of this legislation argue that there is no need for the Federal Government's involvement in this area. Their argument is that the Federal Government should defer to the States and let the States decide if they want exclusive territories.

As you know, Mr. Chairman, I am a strong believer in States' rights, and this legislation does not infringe on States' rights. If anything, this bill does just the opposite.

At present, if a State wishes to provide its wholesalers with an antitrust exemption, the only method available is to make exclusive territories mandatory. All distributors in the State would be forced to comply with such a law.

Currently, there are 27 States which do mandate exclusive territories, including Ohio and South Carolina. Thus, under the present system States are not given a real choice in determining the type of system that they want. It is all or nothing.

With the passage of this bill, States would have a choice. No longer would States have to pass such broad laws to give their distributors an antitrust exemption. This bill does not dictate States to use a particular system. Instead, this legislation only provides an antitrust exemption to qualifying distributors.

This bill would not even require States to change their present laws if they did not want to. What this legislation does do is allow States to choose the distribution system which best suits their situation.

This particular issue has been considered by the Senate on several occasions during the past 7 years, each time being defeated by opponents crying wolf. The arguments against this legislation are now all too familiar. Prices will increase, competition will decrease, and the sky will fall.

Well, Mr. Chairman, I look forward to the hearings and the testimony of the fine group of witnesses we have before us today so that we can get to the truth of the matter, and I believe the testimony today will convince even you, Mr. Chairman.

Before we go to the testimony, Mr. Chairman, if I could, I would like to ask unanimous consent that two documents be entered into the record of these proceedings. The first is a letter that you sent to the witnesses requesting that testimony be received by the subcommittee one week in advance. The second document would be a list prepared by the Subcommittee staff of when each witness' testimony was actually received.

Furthermore, I request that the record be held open for an appropriate length of time to allow for a response to those statements which have been delivered to the subcommittee during the eleventh hour.

I am, Mr. Chairman, making direct reference to Mr. Rule's statement. I am extremely disappointed that the Justice Department cannot play by the rules. Your letter was delivered to them in ample time. They had more than a week to prepare. We got their testimony a few hours ago. It is indeed their observation of this bill, leaving us with little or no time to even read it.

Mr. Rule, I cannot believe that you would operate that way. I thought we had an understanding that we might have some disagreements, but that at least we were going to be honest with each other.

I consider the Justice Department as not only being dishonest in this matter, but absolutely disgraceful. I have nothing more to say to you about it, except I am very sorry that I let your nomination pass the day I did. I could have kept it there at least one more week and I wish I had.

Thank you, Mr. Chairman.

Senator **Metzenbaum**. Without objection, the insertions will be made in the record.

[The prepared statement of Senator DeConcini, along with the documents referred to above, follow:]

PREPARED STATEMENT OF SENATOR DENNIS DECONCINI

Thank you, Mr. Chairman. Initially, let me voice my appreciation for your efforts in scheduling this hearing today. With the busy calendar we all face, it is no small accomplishment to schedule and carry out a hearing such as this at this late date. Thank you again.

As we begin this hearing, I would like to mention a few preliminary points which may provide some perspective on the issue before us.

My first observation is that of the nine Senators serving on this subcommittee, seven represent States which mandate exclusive territories by law. These States include:

Ohio since 1973, represented by our Chairman, Senator Metzenbaum.
Utah since 1977, represented by Senator Hatch.
New Hampshire since 1980, represented by Senator Humphrey.
Pennsylvania since 1980, represented by Senator Specter.
Illinois since 1983, represented by Senator Simon.
South Carolina since 1983, represented by Senator Thurmond.
Alabama since 1984, represented by Senator Heflin.

This is significant because under the doctrine of State action immunity, beer wholesalers in these States, and in 20 other States with such laws, already are immune from Federal antitrust suits insofar as they concern exclusive territories. In fact, beer wholesalers in those States have greater protection from an antitrust challenge than would be provided by S. 567. This bill requires that there be substantial and effective interbrand competition within a territory before an exemption is applicable. There is no such limitation on the immunity granted under State law.

For years opponents of this legislation have contended that passage of this bill would result in an increase in beer prices to the consumers. It seems to me, Mr. Chairman, that if there is any basis at all for opponents' concern about higher prices there should be evidence of that in the experience of States who have mandatory exclusive territories. Now, maybe the chairman knows something about the situation in his home State that I've missed, but the data I have reviewed reaches the opposite conclusion—prices in the exclusive territory States are no higher, and as we will see, there is some indication that they may actually be lower than in non-exclusive territory States.

Opponents have also claimed that beer prices have increased at a faster rate than other common consumer goods. Yet, if you turn your attention to the chart now before you, it is clear that since 1967 beer prices have consistently increased at a slower rate than meat, bread, and, for the most part, milk. As the graph shows, beer prices have remained substantially below the consumer price index. This comparison includes the prices of malt beverage products from both exclusive and non-exclusive territory States.

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This particular issue has been considered by the Senate on several occasions during the last seven years, each time being defeated by opponents crying wolf. The arguments against this legislation are now all to familiar—prices will increase, competition will decrease, and the sky will fall.

Mr. Chairman, I look forward to hearing the testimony of the fine group of witnesses we have before us today, so that we can get to the truth of the matter, and not some unsubstantiated accusations.

I believe the testimony today will, for the first time, unequivically rebut those contentions which hold that this legislation is anti-consumer.

Once more Mr. Chairman, I thank you for your efforts. Chairman Metzenbaum, I would ask unanimous consent that two documents be entered into the record of these proceedings. The first is the letter you sent to the witnesses requesting that testimony be received by the subcommittee one week in advance. The second would be a list prepared by the subcommittee staff of when each witness' testimony was actually received.

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United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-6275

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[illegible], CHIEF COUNSEL AND STAFF DIRECTOR
[illegible], MINORITY CHIEF COUNSEL

SAMPLE WITNESS
LETTER

July 17, 1987

Mr. Charles Rule
Acting Assistant Attorney General
Antitrust Division
Constitution Avenue, between 9th and 10th Streets
Washington, D.C. 20530

Dear Mr. Rule:

The Senate Antitrust, Monopolies and Business Rights Subcommittee has scheduled a hearing on Senator Dennis DeConcini's Malt Beverage Interbrand Competition Bill, S. 567.

I request that you testify regarding the Justice Department's views on this legislation.

The date and time of the hearing is August 4, 1987 at 2:15 P.M., in Room 226 Dirksen Senate Office Building. Senator Metzenbaum will chair the hearing. Due to the number of witnesses, each witness will have only five minutes for an opening statement. However, the written statement may be as long as you like. Please submit 80 copies of your written testimony for the Committee's use, one week prior to the hearing date, to Room 224 Dirksen Senate Office Building.

If you or a representative of the Department is able to testify, please notify Nina Laury of Senator Metzenbaum's staff at 224-5701.

Thank you for your consideration. I look forward to hearing from you.

Sincerely,

Joseph R. Biden, Jr.
Chairman
Committee on the Judiciary

JRB/nl

DATES OF TESTIMONY RECEIVED PRIOR TO THE AUGUST 4, 1987 HEARING ON S. 567 THE MALT BEVERAGE INTERBRAND COMPETITON ACT

PANEL 1

CHARLES RULE, DEPARTMENT OF JUSTICE	TUESDAY, 8/4/87

PANEL 2

ROBERT ABRAMS, NATIONAL ASSOCIATION OF ATTORNEYS GENERAL	FRIDAY, 7/31/87
RODNEY LEONARD, COMMUNITY NUTRITION INSTITUTE	TUESDAY, 7/28/87
ERNEST GELLHORN, JONES, DAY, REAVIS AND POGUE	THURSDAY, 7/30/87

PANEL 3

MICHAEL HENRY, VERMONT RETAIL GROCERS ASSOCIATION	FRIDAY, 7/31/87
ALBERT LEES, LEES' SUPERMARKET	FRIDAY, 7/31/87
MATTHEW DEE, NATIONAL BEER WHOLESALERS ASSOCIATION	THURSDAY, 7/30/87

PANEL 4

RICHARD WILLETT, GRANT THORNTON ACCOUNTING FIRM	THURSDAY, 7/30/87
PETER CARSTENSEN, UNIVERSITY OF WISCONSIN	WEDNESDAY, 7/29/87
ROBERT TOLLISON, CENTER FOR STUDY OF PUBLIC CHOICE	THURSDAY, 7/30/87

Senator **Metzenbaum**. On Mr. Rule's behalf, I just want to say my colleague facetiously that he has been celebrating the fact that he was just sworn in last Thursday and he has been on a constant beer-drinking binge ever since. [Laughter.]

Senator **DeConcini**. His testimony reflects that, Mr. Chairman. [Laughter.]

Senator **Metzenbaum**. We are very pleased that the distinguished ranking member of this committee is with us this afternoon, Senator Thurmond.

Senator **Thurmond**. Thank you, Mr. Chairman.

Mr. Chairman, we are meeting today to hear testimony on S. 567, the Malt Beverage Interbrand Competition Act. This is not the first time that hearings have been held on this type of legislation. In the last Congress, we held hearings on an identical bill, S. 412. I was opposed to that legislation and I continue to be opposed to S. 567.

S. 567 would make it lawful for brewers to establish exclusive territories for the distribution of malt beverage products when such product is in substantial and effective competition with other malt beverage products.

The current treatment of exclusive distributorships and exclusive territories is governed by the Supreme Court's decision in *Continental TV, Inc.* v. *GTE Sylvania, Inc.*, in 1977.

In that case, the Court held that exclusive territories and other non-price vertical restraints are to be judged under the rule of reason and are unlawful only if the adverse effects outweigh any benefits they might yield.

In our consideration of S. 412 in the 99th Congress, we heard testimony from the Justice Department, the Federal Trade Commission, and the American Bar Association that the present law—I repeat, the present law—is clear and works well. S. 567 will only create uncertainty and more litigation.

We also heard testimony from a South Carolina grocer that he could not buy lower-priced beer from another area in the State because of territorial restrictions. Such practices, in my view, will inevitably lead to higher prices for consumers and negatively affect small, independent grocers.

Mr. Chairman, I thank the witnesses for contributing their time and views to our deliberations and I look forward to their testimony.

Senator **Metzenbaum**. Thank you very much.

I will now include in the record the statements of Senators Thurmond, Riegle and Danforth, and a copy of S. 567.

[Prepared statements and the text of S. 567 follow:]

PREPARED STATEMENT OF SENATOR DONALD W. RIEGLE, JR.

To be inserted in the August 4th hearing record on S. 567, the Malt Beverage Interbrand Competition Act:

SENATOR RIEGLE. Mr. Chairman, I am a cosponsor of S. 567, the Malt Beverage Interbrand Competition Act. In the long debate over this bill, the charge has been made that exclusive territories will mean higher prices for consumers. However, I have yet to see a study which convincingly supported that allegation.

The State of Michigan prepared a study in 1985 that covered a 17-year survey of beer prices -- both before and after implementation of its mandatory exclusive territories law in 1977. Under the doctrine of state action immunity, the Michigan law shields beer wholesalers from federal antitrust suits to the extent those suits are based on a challenge of the exclusive territory arrangement.

This study shows that beer prices in Michigan after adoption of exclusive territories declined substantially from $1.04 per six pack at the end of 1976 to $.91 a six pack at the end of 1983. These are, of course, inflation-adjusted prices expressed in 1967 dollars.

A departure from this decline is a moderate rise in prices in 1979, two years after the exclusive territories law went into effect. In explanation of this short-lived departure from the otherwise downward price trend, I would note that Michigan adopted a returnable container law in December 1978 which added significant costs to wholesaler operations. After a year's time, these costs had been absorbed and prices resumed their decline. In fact, the decline was so dramatic that the Michigan Department of Public Health, which sponsored the survey, was led to concede that the record was "an enviable business achievement."

As I understand it, the purpose of the Michigan study was to make a case for an increase in state beer excise taxes, not exactly an objective supported by beer wholesalers. Not only was the study done independent of any beer interest by a Michigan state agency, but the purpose was inimical to those interests.

Mr. Chairman, I ask that the portion of the study that relates to the Michigan experience with exclusive beer territories be included in the hearing record.

Draft #3 6/11/85
(Beertext/202)

AN ANALYSIS OF MICHIGAN BEER PRICES AND BEER REVENUES, 1967-1983

Prepared by the

MICHIGAN DEPARTMENT OF PUBLIC HEALTH
OFFICE OF SUBSTANCE ABUSE SERVICES

Beer Prices, State Revenues, and Inflation

Figure 1 shows price, revenue, and inflation trends in Michigan from 1967 through 1983.(5) The 1967 starting point is taken because this is the year set by the federal government as the most recent base year for calculating the consumer price index (CPI). From 1967 to 1983, the overall price of consumer goods in Michigan increased nearly 300%. Disposable income rose from $2,913 to $9,725, a 230% increase. However, retail beer prices increased by only 220%, meaning that beer prices have declined relative to other products and to the amount of money people have to spend. Over time, beer prices have become comparable to or lower than prices for soft drinks and fruit juices. It must be questioned whether this is a healthy situation for the population as a whole.

State beer tax revenues increased 18.84% from 1967 to 1983. Because 1983 dollars are worth considerably less than 1967 dollars, this represents a decline in revenue over time. Michigan's beer excise tax revenues have steeply declined in value between 1967 and 1983. The 1983 revenues of $43,666,960 are worth only $14,727,474 in 1967 dollars. To have kept even with inflation, 1983 revenues should have been $109,275,552. This means that there was an income "loss" of $65,608,592 in 1983 alone.

BEST COPY AVAILABLE

Figure 1

MICHIGAN BEER PRICES, REVENUES, AND INFLATION, 1967-1983

YEAR	1 BARRELS SOLD	2 BEER EXCISE TAX REVENUE	3 Tax Revenue In 1967 dollars	4 MICHIGAN CPI	5 PER CAPITA DISPOSABLE INCOME	6 MICHIGAN BEER CPI	7 SIX-PACK RETAIL PRICE TAKE-OUT	8 SIX-PACK PRICE IN 1967 DOLLARS
1967	5,832,640	$36,855,161	$36,855,161	100.0	$2913	100.0	$1.23	$1.23
1968	5,855,414	$36,741,982	$35,227,212	104.3	$3133	102.8	$1.26	$1.21
1969	5,829,861	$37,313,892	$33,739,505	110.6	$3311	105.4	$1.30	$1.18
1970	6,302,456	$38,466,376	$32,765,227	117.4	$3423	108.5	$1.34	$1.14
1971	6,310,608	$39,547,160	$32,495,612	121.7	$3719	112.9	$1.39	$1.14
1972	6,507,834	$40,784,125	$32,317,056	126.2	$4017	113.9	$1.40	$1.11
1973	6,443,063	$40,702,070	$30,261,762	134.5	$4506	115.6	$1.42	$1.06
1974	6,805,882	$42,207,094	$28,307,910	149.1	$4823	126.8	$1.56	$1.05
1975	7,019,820	$44,473,106	$27,743,672	160.3	$5153	140.3	$1.73	$1.08
1976	6,971,085	$43,685,361	$25,864,631	168.9	$5699	143.1	$1.76	$1.04
1977	7,431,961	$46,198,769	$25,609,074	180.4	$6340	147.2	$1.81	$1.00
1978	7,301,175	$45,875,704	$23,635,087	194.1	$7060	160.0	$1.97	$1.01
1979	7,012,142	$43,962,254	$20,092,438	218.8	$7750	191.5	$2.36	$1.08
1980	7,005,853	$43,887,440	$17,312,600	253.5	$8348	210.5	$2.59	$1.02
1981	6,968,258	$44,012,367	$15,883,207	277.1	$9208	222.2	$2.73	$.99
1982	6,849,518	$44,709,255	$15,507,892	288.3	$9214	215.3	$2.65	$.92
1983	6,946,711	$43,666,960	$14,727,474	296.5	$9725	220.0	$2.71	$.91

BEST COPY AVAILABLE

During this same time period, it is clear that increases in beer retail prices lagged behind overall inflation increases. While the price of a six-pack rose 220% over the 16 years, prices in general rose by 296.5%. Retail beer prices, then, dropped in effect over time. In 1967 dollars, a six-pack that cost $1.23 in 1967 cost only 91 cents in 1983. Put another way, the price of a six-pack would have risen to $3.65 by 1983 ($1.23 x 2.965), nearly one dollar over the $2.71 price shown in figure 1. That beer prices have not been subject to general inflationary increases may be an enviable business achievement by beer manufacturers. But this achievement has been costly to the citizens of Michigan, in terms of lost State revenues and in terms of greater risks to public health and public safety.

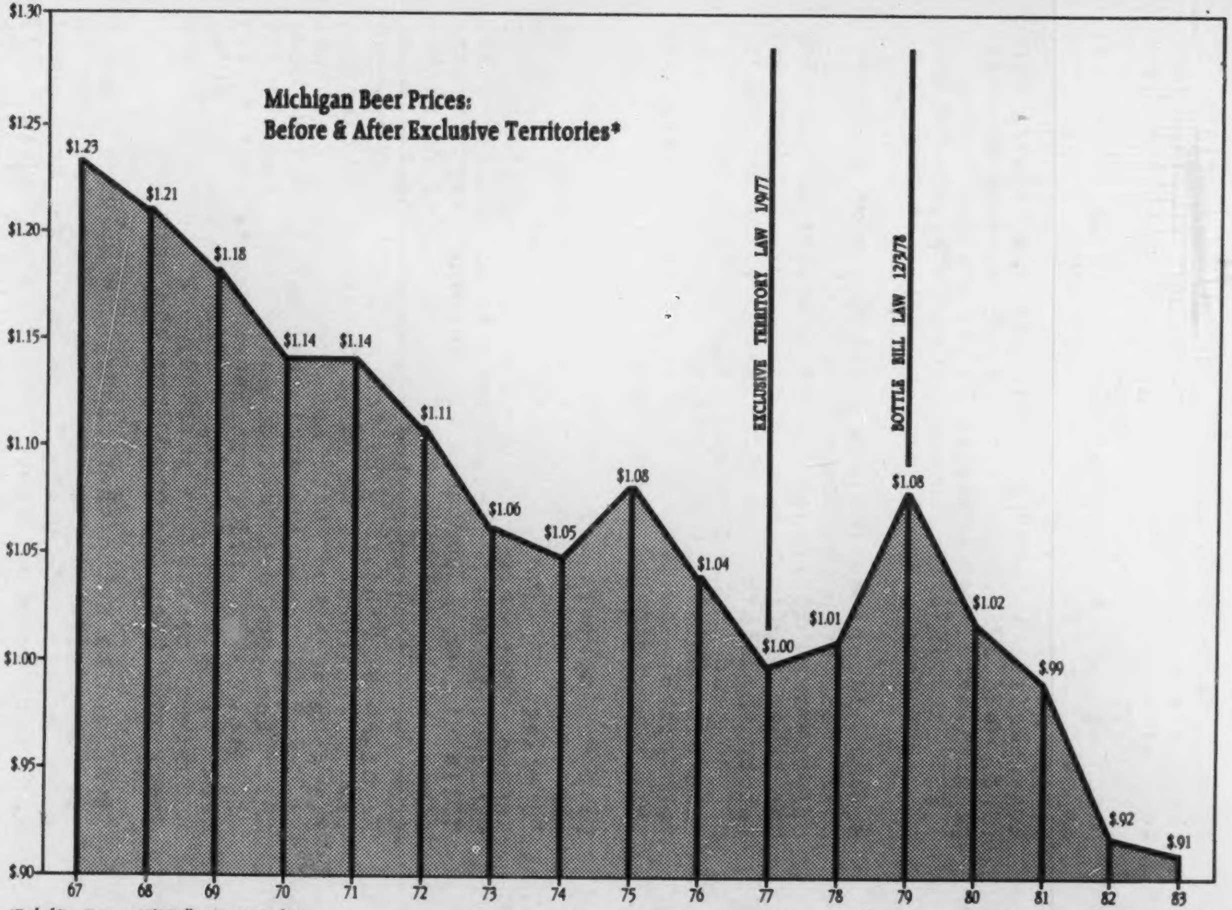
BEST COPY AVAILABLE

Spirits taxes include the State mark-up of 51% on the State's purchase price (Sec. 436.16(1)), which was last revised in 1980 with an increase from 48%. Three specific taxes are applied to the purchase price plus mark-up. One is a 4% tax imposed in 1957, with revenues deposited in the School Aid Fund (Sec. 436.101). A second 4% tax took effect in 1960, applied to the General Fund (Sec. 436.121). A 1% tax applying only to off-premise sales was added in 1973, and increased to 1.85% in 1978, with proceeds deposited in the Liquor Purchase Revolving Fund (Sec.436.131).

Retail licensees receive a 17% discount on their purchases from the State (Sec. 436.16(3)). For off-premises licensees, this discount constitutes the gross profit margin, since take-out prices are set by the State (the MLCC) and may not be raised or lowered. On-premises licensees receive the same discount, but may charge whatever they wish for drinks, so long as the price is not less than what they paid for the alcohol.

5. Data on barrels sold and beer excise tax revenues are from the Liquor Control Commission's 1983 "Statistical look." Michigan CPI and disposable income data are from the Michigan Department of Management and Budget. Data in column 3 (1967 dollars) were computed by dividing each year's revenues by that year's CPI. Beer CPI data are from R. Sjolander and P. Kakela, "Effects of Michigan's Mandatory Beverage Container Deposit Law," Department of Resource Development, Michigan State University, East Lansing, Michigan. Annual six-pack prices are estimated based on the beer CPI, and do not include sales tax and bottle deposit. The price estimates assume that a six-pack of premium domestic beer (e.g., Stroh's, Budweiser) cost $2.71 in 1983. Prices for other years were then computed from the beer CPI.

It should be noted that figures in columns 1 and 2 are inconsistent for some years, in that barrels sold multiplied by the $6.30 tax does not equal the tax revenue figure. For example,the 1983 sales of 6,964,711 barrels would equal $43,764,279 when multiplied by $6.30, not the $43,666,960 shown. Nevertheless, these are the figures published by the MLCC. Discrepancies may be due to calculations being made on a calendar year vs. fiscal year basis, to rebates for lost or broken products, or to accounting variations.



Michigan Beer Prices: Before & After Exclusive Territories*

*End of Year Prices in 1967 Dollars (Per Six-Pack)

Source: Michigan Department of Public Health

PREPARED STATEMENT OF SENATOR STROM THURMOND

Mr. Chairman, we are meeting today to hear testimony on S. 567, the Malt Beverage Interbrand Competition Act. This is not the first time that hearings have been held on this type of legislation. In the last Congress, we held hearings on an identical bill, S. 412. I was opposed to that legislation and I continue to be opposed to S. 567.

S. 567 would make it lawful for brewers to establish exclusive territories for the distribution of a malt beverage product when such product is in "substantial and effective competition" with other malt beverage products. The current treatment of exclusive distributorships and exclusive territories is governed by the Supreme Court's decision in *Continental TV, Inc.* v. *GTE Sylvania, Inc.*, in 1977. In that case, the Court held that exclusive territories, and other non-price vertical restraints, are to be judged under the rule of reason, and are unlawful only if their adverse effects outweigh any benefits they might yield.

In our consideration of S. 412 in the 99th Congress, we heard testimony from the Justice Department, the Federal Trade Commission, and the American Bar Association that the present law is clear and works well. S. 567 would only create uncertainty and more litigation. We also heard testimony from a South Carolina grocer that he could not buy lower priced beer from another area because of territorial restrictions. Such practices, in my view, will inevitably lead to higher prices for consumers, and negatively affect small, independent grocers.

Mr. Chairman, I thank the witnesses for contributing their time and views to our deliberations, and I look forward to their testimony.

PREPARED STATEMENT OF SENATOR JOHN C. DANFORTH

Mr. Chairman, the bill before the Subcommittee, S. 567, is identical to the measure upon which the last Congress conducted hearings, and upon which the Judiciary Committee offered a favorable report. I believe then, and I believe now, that this bill merits our full support.

Many people have expressed concern that this bill might provide a precedent for groups to seek antitrust protection for other products in the future. However, this concern appears misplaced as Congress has already granted identical relief to the soft drink industry. Moreover, beer and other alcoholic beverages stand in a class by themselves because states extensively regulate every aspect of their marketing. To be sure, other consumer products, especially foodstuffs, are subject to a variety of health and safety standards. But I know of no other product on the market that suffers the kind of microscopic supervision attending the sale of beer. As the former Attorney General of a state known for its beer production, I fully appreciate the vast sweep of these state and local regulations.

To one degree or another, the government controls every imaginable aspect of beer distribution including: the manner of distribution, price schedules, advertising, labeling, hours of operation, shipping requirements, credit regulations, deposit laws and excise taxes. Aspects of the beer business not covered by state law fall under the voluminous regulation of alcohol control boards, which are permanent features of every state government.

My point, Mr. Chairman, is that beer differs substantially from other products one would find on a supermarket or department store shelf, and those who argue otherwise are misleading us.

The issue is not whether this legislation sets a precedent. Beer is a unique product with a unique problem: a majority of states today have laws that require beer distributors to sell their product only within exclusive territories. I think there is general agreement on this panel that, under the doctrine of state action immunity, wholesalers in those 27 states are not subject to federal antitrust suits as they relate to vertical restraints. However, in the 22 states that allow but do not require exclusive territories, wholesalers are fully subject to antitrust challenges.

It doesn't make any sense to me that a beer wholesaler in Missouri is free of such suits when a beer wholesaler a few miles down the road in Arkansas, engaged in exactly the same business practice, can be hauled into federal court at any time. I don't know of any other product that is subject to this kind of a double antitrust standard.

There are two proposed approaches to this problem. First, we can provide a reasonable threshold test for these kind of suits. Congress took this approach with soft drink distributors in 1980, and S. 567 proposes the same course of action for beer wholesalers. Alternatively, we can simply consider this a state problem; if states want to help their wholesalers, they should pass state laws that require exclusive territories, much the way Missouri, Ohio and New Hampshire have done. I have no difficulty finding S. 567 the better of the two choices.

Mr. Chairman, my state of Missouri enacted a law requiring exclusive beer distributorships in September 1985. Mr. Richard Willett, a partner in the accounting firm of Grant Thornton, has analyzed data on prices before and since adoption of that law and has found no basis for the concern that exclusive territories will lead to higher consumer prices. I urge the Committee to act favorably on the bill before it.

II

100TH CONGRESS
1ST SESSION

S. 567

To clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 19, 1987

Mr. DECONCINI (for himself, Mr. SIMPSON, and Mr. EXON) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

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A BILL

To clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. That this Act may be cited as the "Malt Beverage Interbrand Competition Act".

SEC. 2. Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any written contract in effect on or entered into after the effective date of this Act by any brewer, importer, trademark owner, or trademark licensee of a trademarked malt beverage with any wholesale distributor of provisions granting the wholesale distributor the sole and exclusive right to distribute and to sell such product in any defined geographic area within any State and limiting such exclusive distributor to the distribution and sale, directly or indirectly, of such product only for ultimate resale to consumers within that defined geographic area when such product is in substantial and effective competition with other malt beverage products within that defined geographic area.

SEC. 3. Nothing in this Act shall be construed to legalize the enforcement of provisions described in section 2 of this Act in any written contract described in that section by means of price-fixing agreements, horizontal restraints of trade, or group boycotts, if such agreement, restraints, or boycotts would otherwise be unlawful.

SEC. 4. As used in this Act, the term "antitrust law" means the Act entitled "An Act to protect trade and commerce against unlawful restraints and monopolies" (Sherman Act), approved July 2, 1890, the Federal Trade Commission Act, approved September 26, 1914, and the Act entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes" (Clayton Act), approved October 15, 1914, and all amendments to such Acts.

SEC. 5. As used in this Act, "malt beverage" shall mean and include beer of all types and varieties as defined in any Federal or State statute, ale, porter, stout, and all other similarly designated fermented beverages containing one-half of 1 per centum or more alcohol by volume.

SEC. 6. As used in this Act, the term "State" includes the District of Columbia and any territory or possession of the United States.

SEC. 7. This Act shall not invalidate or affect any provision of the laws of any State.

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Senator **DeConcini**. Also, Mr. Chairman, may I include two statements here, one from Senator Simpson and another one from Mr. Kerr, National Beer Wholesalers in Ohio?

Senator **Metzenbaum**. The statement of Senator Simpson will be included at this point.

[Prepared statement follows:]

STATEMENT OF SENATOR ALAN K. SIMPSON
BEFORE THE SUBCOMMITTEE ON
ANTITRUST, MONOPOLIES, AND BUSINESS RIGHTS REGARDING
S. 567, THE MALT BEVERAGE INTERBRAND COMPETITION ACT
AUGUST 4, 1987

I have once again joined with Senator DeConcini and Senator Exon as an original cosponsor of this legislation in the 100th Congress. This legislation is very necessary in order to maintain a system of malt beverage wholesale distribution which is working quite well and which should be maintained. Additionally, this bill will codify the rulings of the Supreme Court of the United States and in turn help to prevent nuisance law suits brought against beer wholesalers for alleged antitrust violations -- all done in spite of the rulings of the Supreme Court on the matter. Avoidance of unnecessary litigation will save many a small businessman in the beer wholesaling industry from a great deal of time, aggravation and expense.

The legislation would also contribute to a more efficient state control of malt beverages and the collection of state excise taxes on malt beverages and reinforce states' rights under the 21st Amendment.

The purpose of S. 567 is simply to protect beer wholesalers from antitrust actions when a brewery grants a wholesaler the sole and exclusive right to distribute its product in any defined geographical area -- so long as the product is in "substantial and effective competition with other malt beverage products within that defined geographic area." Consequently, the traditional malt beverage franchise system will be codified under this bill and remain lawful under antitrust laws as long as there is substantial and effective interbrand competition within the geographic area.

At the same time, the bill specifies that it is not intended to immunize the industry from other antitrust laws regarding price-fixing agreements, horizontal restraints of trade, or group boycotts.

Also of importance is the provision in the bill which specifically states that this act shall not invalidate or affect any provisions of laws of any state. Consequently, the 21st Amendment providing the right of each state to regulate the distribution of beer shall not be interfered with and each state may determine in its legislature whether it wishes to impose such antitrust measures as it deems appropriate on the distribution of malt beverages.

The Supreme Court decision in Continental TV, Inc. vs GTE-Sylvania, Inc. in 1977 held that territorial agreements between manufacturers and wholesalers do not per se violate the Sherman Antitrust Act. The court held that each case should be evaluated using a "rule of reason" based upon a factual assessment of reasons for the agreement and its consequences. This legislation merely codifies the ruling and makes its application uniform to the beer wholesaling industry without interfering with the right of states to act in this matter.

Much has been made by some opponents to the legislation that this bill would alledgedly result in a tremendously high increase in the cost of malt beverages to consumers. Studies performed by professors at George Mason University and Auburn University however dispute those findings. The study undertook a review of beer prices in the 27 states which mandate that beer be distributed only through exclusive territorial agreements and compared the states to the other states which have no such legally mandated distribution requirements. The study found that retail beer prices are no higher in states that mandate exclusive territories than in states which do not. Additionally, an examination of the soft drink prices after adoption of the 1980 Soft Drink Interbrand Competition Act, which is identical to this bill, supports the finding that there is no adverse price relationship between exclusive territories and consumer prices.

The economic factors which do affect the retail price of beer include (1) the level of consumer income, (2) the prices of substitute beverages such as wine, soft drinks and distilled spirits, (3) label costs, and most importantly, (4) state laws restricting retail beer advertising.

In conclusion then may I emphasize: Because this bill merely codifies current Supreme Court rulings; because the bill does not interfere with states rights; because the bill will promote more efficient distribution of beer and will discourage nuisance antitrust litigation, and because other antitrust provisions remain intact with respect to otherwise illegal antitrust activities, I strongly encourage my colleagues to support this legislation and to report it favorably to the full committee for consideration.

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Senator **Metzenbaum**. The statement of the gentleman from Ohio will be included at some later point after the witnesses rather than before them.

Senator **DeConcini**. Very good.

Senator **Metzenbaum**. Mr. Rule, we are happy to have you appear before us—pardon me, Mr. Rule. We also have a statement of Senator Humphrey, and I guess it is against it, but I am not certain. The statement of Senator Humphrey will be included against the bill.

PREPARED STATEMENT OF SENATOR GORDON J. HUMPHREY

Mr. Chairman, I have serious concerns and reservations regarding the legislation we are considering in this hearing.

This bill, S. 567, will carve out a special antitrust immunity for exclusive distributorships for brands of beer and other malt beverages. As I undersand it, the bill will effectively protect what amount to territorial monopolies in the distribution of beer brands, with the result that there will be no intra-brand competition, and no alternative source of supply, in the marketing territories where such arrangements exist.

I was opposed to this bill when we considered it in the 99th Congress and the reasons for my opposition then have not been removed.

I fail to see how it is in the best interests of consumers, retailers, or vigorous competition in the beer industry to grant a special antitrust exemption for distribution monopolies in areas which in some cases may cover an entire State. I fail to see how we enhance competition with legislation that will force retailers to become dependent upon a single source of supply.

I recognize that there are arguments that these exclusive distributorships may be conducive to more efficient distribution arrangements. I suppose monopolies are more efficient in some senses than competition, just as dictatorships in some senses are more efficient than democracies. On the other hand, there appears to be substantial evidence that the "efficiency" argument does not hold up broadly in actual practice as it does as a theoretical proposition. In any event, I am not persuaded that the distribution efficiencies that might result are sufficient to justify the tangible harms that would result if we give this "blank check" to exclusive beer distributorships.

Finally, it appears that under existing law set forth in the *GTE Sylvania* case, exclusive distrubution arrangements only violate the antitrust laws if they can be conclusively shown to have an anti-competitive effect. That standard seems to leave ample leeway for the defense of legitimate exclusive distribution arrangements which do not unduly lessen competition.

In sum, I urge my colleagues to be very wary of this proposal for what appears to be an unwarranted special exemption from the application of basic antitrust principles.

Senator **Metzenbaum**. Senator Riegle's statement was included. I believe he favors the bill.

Mr. Rule, we are now happy to hear from you. The Subcommittee will try to adhere to a five-minute rule, which is customary for this committee. Please proceed.

STATEMENT OF CHARLES F. RULE, ASSISTANT ATTORNEY GENERAL, ANTITRUST DIVISION, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. **Rule**. Thank you, Mr. Chairman and members of the subcommittee. It is a pleasure to be here this afternoon on behalf of the Department of Justice. As you likely already know, I appear once again to renew the Department's opposition to the latest so-called beer bill, S. 567, the Malt Beverage Interbrand Competition Act.

Let me say, first of all, I apologize to the committee for not having gotten our testimony here earlier, and we will do everything we can in the future from here on out to try to get the testimony here on time. It certainly was not intended to deprive you of the benefit of our analysis which, frankly, is pretty much the same as it has been for the last three or four times we have testified.

Before answering your questions, I would like to make three points that are made in my full testimony. First, despite our opposition to S. 567, let me make it clear that the Department, and indeed the courts, recognize the benefits of exclusive territories.

Such restrictions can provide important distributional efficiencies. Moreover, the courts do not, and should not condemn exclusive territories or other vertical non-price restraints in the malt beverage industry or any other industry unless those restraints truly threaten consumers.

Our opposition to this bill should not by any means be interpreted as a view that exclusive territories, even in the malt beverage industry, are generally anticompetitive, that they are likely to increase prices, or that they should be deemed per se unlawful.

Second, having said that, our opposition to S. 567 is based on a recognition that to the extent exclusive territories ever threaten competition, the likelihood of that threat is as great in the malt beverage industry as in any other.

That industry is highly concentrated, generally, and is not easily entered by newcomers. These are structural prerequisites to any possibility of an anticompetitive effect from exclusive territories, and these are structural characteristics that are absent from most industries, but not from the malt beverage industry.

This concern that we have with the possibility of a new standard creating some threat of anticompetitive behavior may not be entirely theoretical, I should add, in light of the Division's recent criminal investigations and prosecutions in the soft drink bottling industry.

Those have been well chronicled and they are ongoing, and we have indeed found a pattern of price fixing among the soft drink bottlers.

Third, and by far most important, our opposition is based on the legal confusion that we believe S. 567 would engender. The standard in the bill has no fixed meaning in the cases and will likely create legal confusion.

The bill could even call into question the legality of vertical restraints, such as exclusive territories, used in other industries that do not have the benefit of special legislation.

If there is a need for clarification of the standard applied to exclusive territories—and at this point I do not believe there is—it should be brought about across the economy, not in select industries, and certainly not just in the malt beverage and soft drink industries.

Having made those three points, Mr. Chairman, I will be happy to answer any questions that the members of the Subcommittee might have.

Senator METZENBAUM. Mr. Rule, it is my understanding, if you know, that the White House Department of Consumer Affairs and the Federal Trade Commission are also both opposed to the beer bill.

Mr. RULE. It is certainly my understanding that the FTC is. I really am not sure about the White House Office of Consumer Affairs.

Senator METZENBAUM. The Chair will rule that their statements, when submitted, will be put in the record, assuming they are submitted within a reasonable time after conclusion of the hearings.

[Prepared statement follows:]

Statement of
The Federal Trade Commission

on

S. 567
The Malt Beverage Interbrand Competition Act

* * *

Committee on the Judiciary
United States Senate

July 31, 1987

We are pleased to have this opportunity to submit our views on S. 567, the Malt Beverage Interbrand Competition Act. The proposed legislation is almost identical to bills that were introduced but not enacted during the last three Congresses. The Commission presented testimony opposing the previous bills, and we oppose the enactment of S. 567 as well. Our comments here in large part parallel and restate the testimony that we presented in May of 1985, when the Judiciary Committee held hearings on a predecessor of the present bill. 1/

The operative provision of S. 567 is section 2, which provides that it shall not be an antitrust violation for brewers to enter into agreements granting wholesale distributors an exclusive right to distribute and sell a malt beverage in a defined area, so long as that malt beverage is in "substantial and effective competition" with other malt beverage products in the relevant market. 2/ This provision would create a special new antitrust standard -- applicable only to the malt beverage industry -- for testing the lawfulness of what are known as "airtight" vertical exclusive territorial agreements. This proposed legislation, by importing a new and ambiguous standard into an-

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1/ See The Malt Beverage Interbrand Competition Act: Hearings on S. 412 Before the Committee on the Judiciary, 99th Cong., 1st Sess. 34-56 (1985) (Commission statement presented by Walter T. Winslow, Deputy Director, Bureau of Competition, Federal Trade Commission).

2/ Unlike the versions of this bill introduced during the 97th and 98th Congresses, S. 567 would apply to existing contracts as well as to contracts entered into after enactment of the bill.

titrust law, will at best have the effect of creating uncertainty, and appears more likely to injure consumers by granting the malt beverage industry an unjustified exemption from the antitrust laws.

The Commission opposes S. 567 for four discrete reasons. First, if the new standard set forth in the bill -- "in substantial and effective competition with other malt beverage products" -- is intended merely to restate existing law, 3/ it is superfluous and confusing. The new standard does not clarify the law, and there is a danger that it would be interpreted as a partial or total antitrust exemption rather than as a clarification.

Second, if the proposed statutory standard is meant to alter the existing rule of reason standard presently applicable to the malt beverage industry, its adoption would injure consumers. Under the rule of reason, exclusive territorial restraints are legal unless they are demonstrably anticompetitive and injurious to consumers. Consequently, a more lenient standard would legalize arrangements that _are_ anticompetitive and injurious -- arrangements that result in restricted output, diminished service, and higher prices.

3/ The intent of S. 567 is not clear on its face. Testimony in support of a predecessor bill in the 99th Congress indicated alternatively that the bill would merely clarify the rule of reason standard that is presently applicable to exclusive territorial restraints in the malt beverage industry, _see_, _e.g._, _Hearings on S. 412_, _supra_ note 1, at 97-98 (statement of Ernest Gellhorn), or displace the rule of reason with a more lenient standard that would protect wholesalers from "unhealthy competition," _see id._ at 267-69 (statement of Paul Klett). In either event, for the reasons stated below, the Commission opposes enactment of this legislation.

Third, because the malt beverage industry exhibits the structural characteristics that make it particularly amenable to the anticompetitive use of exclusive territorial arrangements, it is a particularly inappropriate industry for a more lenient standard for scrutinizing exclusive territorial arrangements.

Fourth, to the extent that the new statutory standard is more lenient than the rule of reason standard, the proposed legislation would, in effect, grant a special exemption from the antitrust laws to the malt beverage industry. In general, the enactment of special exemptions has the detrimental effect of undercutting the ability of antitrust enforcement to preserve this nation's free market economy. The Commission fully supports Congress's traditional refusal to grant an industry special status under the antitrust laws unless and until there is compelling evidence of the unworkability of competition or of a clearly paramount social purpose. No such showing has or could be made for the malt beverage industry.

I. A SHORTHAND VERSION OF THE EXISTING RULE OF REASON STANDARD IS UNNECESSARY AND DANGEROUS

A number of purported justifications have been put forward in the last three Congresses for enacting a special gloss on the rule of reason as applicable to malt beverage distribution. The justifications have been inconsistent, an inconsistency that highlights the absence of a need for the legislation; like its predecessors, S. 567 is a solution in search of a problem.

In testimony before this Committee in the 97th Congress, some proponents of the Malt Beverage Interbrand Competition Act claimed that the bill was necessary to ensure that exclusive territorial arrangements were governed by the rule of reason rather than by the *per se* rule. In 1977, however, the United States Supreme Court in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), held that *all* nonprice vertical restraints are to be subject to a rule of reason analysis. To support the need for legislation to make exactly the same point, proponents of the bill referred only to one California state court case that had applied a *per se* standard to a vertical restraint involving the distribution of distilled spirits. The United States Supreme Court later reversed the California court, however, in a way that eliminated any legitimate concerns that the malt beverage industry may have had. 4/

In the 98th Congress and 99th Congresses, some advocates of this legislation sought to justify it not as an affirmation of the rule of reason, but as a means of clarifying how exclusive territorial arrangements should be analyzed under that rule. According to this argument, by clarifying the rule of reason, the new standard would provide greater certainty and save litigation costs, while not sacrificing any of the protection consumers

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4/ Rice v. Norman Williams Co., 458 U.S. 654 (1982). Finding that a state "designation statute" authorized conduct that would be *per se* illegal under federal antitrust law, a California Court of Appeals had held the statute invalid on its face. The Supreme Court reversed and remanded on the ground that the statute authorized conduct that might be found legal under the correct antitrust analysis, *i.e.*, under a rule of reason test.

receive from the rule. 5/ This argument lacks merit for two reasons.

In the first place, there is no reason to believe that vertical restraints analysis could be made clearer by the adoption of a new statutory "shorthand" phrase. The term "substantial and effective competition" will not provide guidance. In fact, since it is unclear what the term means, it would create confusion rather than clarity. 6/

In the second place, the new standard cannot both save litigation costs and provide the public the protection it currently receives from the rule of reason. If the new standard is meant to be only a recodification of existing law, its application in a litigation setting would entail the exact same costs and uncertainty as are incurred under the application of the rule of reason. The new standard could save litigation costs only if it excluded one or more of the inquiries that are presently undertaken under the rule of reason. By deleting those inquiries, the new standard would not be a recodification of -- but would instead be a more lenient substitute for -- the rule of reason. As

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5/ See Malt Beverage Interbrand Competition Act: Hearings on S. 1680 Before the Senate Committee on the Judiciary, 98th Cong. 2d Sess. 45 (statement of Ernest Gellhorn); id. at 89 (statement of William D. Young); Hearings on S. 412, supra note 1, at 97-112 (statement of Ernest Gellhorn).

6/ If the new standard is a codification of the rule of reason, the phrase "substantial and effective" would have a different meaning in every case, depending on the nature of the intrabrand restriction(s) and on the peculiar facts of each market.

such, the new standard would injure consumers by legalizing restraints presently violative of the antitrust laws.

The danger associated with the adoption of shorthand statutory phrases is evidenced by the way the judiciary interpreted a similar phrase in the Miller-Tydings Act. 7/ That Act exempted "agreements prescribing minimum prices for the resale of a [branded] commodity which . . . is in free and open competition with commodities of the same general class produced or distributed by others," when such agreements are permitted in the state of resale. The legislative history of the Miller-Tydings Act indicates that Congress intended the "free and open competition" requirement to ensure that resale price maintenance agreements would be permitted only if there existed sufficient interbrand competition to prevent the agreements from having anticompetitive effects. 8/ The courts, however, largely ignored the

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7/ Section 1 of the Sherman Act was amended in 1937 by the Miller-Tydings Act, which was repealed in 1975. 89 Stat. 801 (1975).

8/ *See* 81 Cong. Rec. 7495, 8141 (1937). In a discussion on the Senate floor concerning this Act, Senator Tydings stated:

> What does the amendment do? It permits a man who manufactures an article to state the minimum resale price of the article in a contract with the man who buys it for ultimate resale to the public, provided -- and this "provided" is mountain-high -- that the article about which the contract is written is in free and open competition with other articles. If it is not in free and open competition with other articles, no such contract may be written.

Id. at 7495 (emphasis supplied).

requirement of "free and open competition,"[9] and by the time Congress repealed the Miller-Tydings Act in 1975, the shorthand phrase was void of any substantive import.

In the 99th Congress, proponents of the legislation put forth a different variation of the claim that the legislation is needed to affirm existing law. Some supporters of the bill claimed that it was necessary to affirm the authority of the states to regulate beer distributors.[10] So far as we are aware, however, there is no reason to question the states' full regulatory authority in this area. The Supreme Court has made it clear that the federal antitrust laws do not preempt state laws governing exclusive territorial restrictions.[11] Under existing law, moreover, states are unilaterally able to confer state action immunity from federal antitrust laws by establishing a regulatory scheme that satisfies the tests enunciated by the

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[9] For instance, one court construing the Act's language held that a manufacturer could meet the "free and open competition" standard merely by demonstrating the non-existence of horizontal agreements. Scovill Mfg. Co. v. Skaggs Pay Less Drug Stores, 275 P.2d 619, 625 (Cal. App. 1954), vacated on other grounds, 291 P.2d 936 (1955). Another court held that the standard required only a showing that a purchaser "must be able to buy [the product] from more than one manufacturer." Eastman Kodak Co. v. Federal Trade Commission, 158 F.2d 592 (2d Cir. 1946), cert. denied, 330 U.S. 828 (1947); See also Eastman Kodak v. Home Util. Co., 234 F.2d 766 (4th Cir. 1956), appeal dismissed 352 U.S. 956 (1957).

[10] See, e.g., Hearings on S. 412, supra note 1, at 255 (statement of Marion Carnell) (legislation needed to "reinforce" state law concerning exclusive territorial agreements).

[11] Rice v. Norman Williams Co., 458 U.S. 654 (1982). The right of states to regulate beer distributors is guaranteed by the twenty-first amendment to the Constitution.

Supreme Court in the Midcal case. 12/ Consequently, the bill is unnecessary to affirm state regulatory authority. And even if some question existed as to the states' authority, S. 567 would not remedy it, since the bill's provisions concern the federal antitrust laws and do not even address issues concerning state regulation. Although the bill's enactment would not enhance state authority, it would create the risk of an overly broad antitrust exemption for the malt beverage industry.

In sum, if S. 567 is intended as an affirmation and clarification of the rule of reason or the federal preemption law, the Commission opposes the bill both because it is unnecessary and confusing and because of the danger -- exemplified by the Miller-Tydings Act experience -- that courts will read the bill as creating a partial or total antitrust exemption for exclusive territorial restrictions in the malt beverage industry.

II. ADOPTION OF ANY STANDARD MORE LENIENT THAN THE RULE OF REASON WOULD HARM CONSUMERS

Under the rule of reason, exclusive territorial arrangements are legal unless they injure competition and consumers. Therefore, the effect of a more lenient standard would be to legalize arrangements that would restrain output and increase prices.

12/ California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 105-06 (1980). Under Midcal, state action immunity from the antitrust laws is available to private parties if their conduct is undertaken pursuant to a clearly articulated and affirmatively expressed state policy to displace competition and the conduct is actively supervised by the state.

The Commission believes that the rule of reason is the correct antitrust standard to apply to territorial restrictions imposed unilaterally by a manufacturer on its distributors. Under the rule of reason, all relevant economic factors are examined to determine whether a challenged restraint, on balance, injures competition -- that is, whether the restraint's anticompetitive effects are outweighed by its procompetitive effects. Only if it is established that a practice has a net anticompetitive effect is the practice unlawful. 13/

For example, the Commission's Beltone 14/ decision explains that an exclusive territorial arrangement restricting intrabrand competition is illegal only if it results in harm to interbrand competition. In its opinion, the Commission identified the relevant competitive concerns 15/, and explained the factors that

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13/ National Society of Professional Engineers v. United States, 435 U.S. 679 (1979). The rule of reason standard permits consideration of countervailing competitive justifications for the alleged restraint.

14/ Beltone Electronics Corp., 100 F.T.C. 68 (1982).

15/ The Commission stated that:

> In considering the negative impact on interbrand competition in this context, it is important to clarify that what we are concerned about are horizontal effects at either the manufacturer or dealer level. These effects can be manifested in several ways: a) as actual collusion among competitors which increases prices and restricts output; b) as an increased likelihood of anticompetitive interdependent behavior or oligopolistic pricing which yields results similar to collusion; or c) as enhancement or creation of market power on the part of one or more sellers.

Id. at 206-07.

must be examined in analyzing the likely effects of such a restraint, including the structure, performance, and dynamics of the industry, the seller's marketing strategy, and the likely efficiencies to be gained from the restriction. 16/

Because the rule of reason takes into account suppliers' reasons for imposing vertical restraints, there is no basis for any claim that the new legislation is needed for brewers to operate distribution systems that promote competition and efficiency. For example, it has been argued that legislation is needed so that the industry can restrict the undesirable transshipment of their product. However, if transshipment restrictions in fact enhance competition among different brands of beer by assuring needed services (e.g., stock rotation) or by avoiding consumer purchases of stale beer, then the rule of reason would not prevent the adoption of reasonable transshipment rules, including total bans in appropriate circumstances. Indeed, the Commission has modified a series of orders in recent years specifically to permit restrictions on transshipments meant to strengthen a seller's competitive position. 17/ Unless such restrictions have adverse interbrand effects, they are currently legal; and if they do have adverse interbrand effects, they should not be permitted.

16/ Id. at 206-09. See also Roland Machinery Co. v. Dresser Industries, Inc., 749 F.2d 380 (7th Cir. 1984).

17/ E.g., Magnavox Co., 102 F.T.C. 807 (1983); U.S. Pioneer Electronics Corp., 101 F.T.C. 372 (1983); Lenox, Inc., 100 F.T.C. 259 (1982).

In sum, because the rule of reason permits exclusive territorial arrangements except where they demonstrably injure competition and consumers, a less strict standard would legalize at least some arrangements that demonstrably injure competition and consumers. The effect would be to legalize arrangements that restrict output and increase prices, without providing countervailing benefits. 18/

III. THE STRUCTURE OF THE MALT BEVERAGE INDUSTRY MAKES IT PARTICULARLY INAPPROPRIATE FOR MORE LENIENT SCRUTINY UNDER THE ANTITRUST LAWS

The Commission believes that the malt beverage industry is an especially inappropriate one to select for lenient treatment in determining the legal propriety of exclusive territorial arrangements. Although exclusive territorial arrangements can serve legitimate marketing goals and thus be procompetitive, circumstances can arise in which the use of such restraints may be anticompetitive. 19/

18/ We note, however, that increased prices alone are not a sufficient basis for finding exclusive territorial arrangements unlawful. Because exclusive territorial arrangements are often designed to promote increased services, they may lead to higher prices. Consumer welfare is not harmed when higher prices reflect solely the added value to consumers from the additional services.

19/ Exclusive territories can be procompetitive, for example, if they encourage dealers to provide promotional and other point of sale services. A distributor's incentive to promote a brand will be reduced if other sellers of the same brand can free ride on his promotional expenditures. A brand that is not actively promoted by its dealers will lose sales to competing brands that are more vigorously promoted, and ultimately interbrand competition will be harmed. Exclusive territorial arrangements can prevent free riding and thereby enhance interbrand competition.

Exclusive territorial arrangements can facilitate collusion among competing wholesalers of different brands of beer. If there are regulatory barriers to entry at the wholesaler level -- as we understand is frequently the case in the distribution of malt beverages -- wholesalers for different brewers could use exclusive territorial franchising as part of a scheme to exclude potential competition from wholesalers in other areas and charge monopoly prices. Although the bill does not legalize collusion, it reduces the economic barriers to collusion and thus may make its occurrence more likely.

The likelihood of a successful conspiracy will also be affected by the structural conditions of the industry in question. As a general proposition, in an industry where there are large numbers of competitors, low concentration, and low barriers to entry, the cost of collusion will be high and hence is less likely to occur. However, in an industry where there are small numbers of competitors, high concentration, and high barriers to entry, the cost of collusion is lower and hence its likelihood increased.

The malt beverage industry exhibits structural characteristics associated with an increased risk that exclusive territorial arrangements will be used in an anticompetitive manner. 20/ The brewing industry is quite highly concentrated.

20/ In 1978 the Commission issued a staff report on the brewing industry. This report found that concentration was increasing in brewing, but that brewing was generally competitive. However, the staff report is ten years old and did not analyze the struc- (continued...)

Four firm concentration in beer brewing increased at the national level from 46 percent in 1970 to 79.2 percent in 1986. 21/ Moreover, in most states, four firm concentration exceeds 80 percent. We also understand that wholesaler concentration is high -- perhaps higher than brewer concentration -- though we do not have reliable data on this aspect of malt beverage distribution. Finally, we understand that the laws of many states create barriers that restrict entry into the wholesale distribution of malt beverages.

IV. ADOPTION OF A STANDARD MORE LENIENT THAN THE RULE OF REASON IS AN UNJUSTIFIED EXEMPTION FROM THE ANTITRUST LAWS

The malt beverage industry has made no showing that would warrant special treatment under the antitrust laws. Although numerous industry groups have sought special antitrust status in recent years, Congress has repeatedly refused their requests, thus reaffirming the nation's commitment to a competitive economy and rejecting the piecemeal adoption of special exemptions, standards, or status for particular industries. As the National Commission for the Review of Antitrust Laws and Procedures aptly stated, special antitrust status should only be granted "where

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20/(...continued)
ture of the malt beverage wholesaling industry, which at the regional level appears to be highly concentrated. Moreover, the fact that an industry is functioning competitively would not justify granting an antitrust exemption that would legalize anticompetitive behavior.

21/ This is an increase from the 76.8 percent level reported when we commented on a predecessor of this bill two years ago.

there is compelling evidence of the unworkability of competition or a clearly paramount social purpose." 22/

Moreover, there is an important structural difference between the malt beverage industry and the soft drink industry, for which Congress in 1980 enacted an exemption that appears similar to the one proposed in S. 567. 23/ While concentration in the soft drink industry is also relatively high, that industry does not have governmentally imposed barriers to new entrants whose presence could prevent competitive problems. This consideration makes it less appropriate to give the malt beverage industry special status under the antitrust laws.

V. CONCLUSION

In summary, the Commission is strongly opposed to the adoption of S. 567. Since the antitrust laws currently permit procompetitive exclusive territorial arrangements, the only exclusive territorial arrangements that could be legalized by a weakening of current antitrust standards are those arrangements whose overall effect is anticompetitive and injurious to consumers. Moreover, our view of competitive conditions in the malt beverage industry serves to reinforce our opposition to S. 567,

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22/ National Commission for the Review of Antitrust Laws and Procedures, Report to the President and the Attorney General 177 (1979). Proponents of S. 567 argue that the bill is not an exemption, but this argument is only semantic, because the bill would exempt the malt beverage industry from the usual antitrust prohibitions relating to exclusive territorial agreements.

23/ The Soft Drink Interbrand Competition Act, 15 U.S.C. §§ 3501-03.

because the industry appears to be one in which it is particularly important to safeguard against the anticompetitive use of exclusive territorial arrangements.

Finally, we are unaware of basis for providing special antitrust status for the malt beverage industry, and we believe that enactment of such an unjustified special exemption would undercut the ability of antitrust enforcement to preserve this nation's free market economy.

Senator METZENBAUM. I have no questions.

Senator Thurmond.

Senator THURMOND. Thank you, Mr. Chairman.

Mr. Rule, I remember when the bill was up previously I had a little grocer from Barnwell, South Carolina. He lives approximately halfway between Columbia and Charleston, and he said he wanted to have the opportunity to buy beer—I think it was Budweiser; I am not sure now which brand—either in Columbia or Charleston, but if this bill passed, he could not do that. He would have to buy from one place, which would give that place a monopoly, so to speak.

Is that your practical knowledge of the bill?

Mr. RULE. Well, let me answer that question this way. I am not exactly sure how any individual circumstance might come out under this bill as opposed to the way it would come out today without the legislation.

I am pretty confident that the answer to that question will be more confused if this bill passes. It is certainly not unlikely that some brewers who have not chosen to do so thus far will decide to use exclusive territories if this bill is enacted.

Senator THURMOND. Mr. Gellhorn, in his prepared remarks, states that over the last decade the application of the antitrust laws to vertical restraints has become more confused, and therefore the case for antitrust clarification is stronger than ever.

He views S. 567 as providing such clarification. Do you agree with either position?

Mr. RULE. No, sir, I really do not. If anything, I think this bill would confuse things further. The problem is that the language used in the statute does not really have a developed body of law that makes it an easily understood phrase in the law.

There is even an argument that the phrase used in this bill is less flexible and might, under some circumstances, be less accommodating to pro-competitive exclusive territories than the current standard used by the courts following the Supreme Court's 1977 *Sylvania* decision.

So I do not think this bill will clear things up. If anything, I think it will make the law more confusing.

Senator THURMOND. In your opinion, does this bill create more monopolies and therefore is not in the best interests of the consumers?

Mr. RULE. Again, it is very difficult to say whether there will be more monopolies. As I said, I would not be here to argue that exclusive territories should be per se unlawful.

It is true, though, that if you create a special standard for the beer industry, it will be more difficult to challenge exclusive territories when they are, in fact, anticompetitive. It may also send the wrong signal to the industry in terms of its ability not to abide by the rules of competition by which every other industry abides.

As a result, there may be anticompetitive increases in price, and those clearly will work to the detriment of consumers.

Senator THURMOND. I have no more questions at this time.

Senator METZENBAUM. Thank you.

Senator DeConcini.

Senator DECONCINI. Mr. Chairman, thank you.

Mr. Rule, not having your statement in time in accordance with the Chairman's request, I will ask the Chairman if I may submit questions to you. I accept your apology for non-compliance with the rules of this committee, and I will ask no questions at this time.

Thank you, Mr. Chairman.

Senator METZENBAUM. Mr. Rule, I do have one or two questions. As a general rule, do you think industry in this country should be subject to the antitrust laws?

Mr. RULE. Yes.

Senator METZENBAUM. And today, all industries, with the exception of two and those that are regulated, are subject to the antitrust laws, is that correct?

Mr. RULE. Most industries are subject to the antitrust laws. You may be thinking of soft drinks and insurance as unregulated industries. You might be able to find some more—I do not know—that have special exemptions. For example, agriculture might be considered one, although there is obviously a lot of government involvement in agriculture.

But it is true that generally, industries in the United States, and certainly the ones that are unregulated, are fully subject to the antitrust laws.

Senator METZENBAUM. Do you support the concept that, generally, businesses and industries should be subject to the antitrust laws?

Mr. RULE. Yes, sir.

Senator METZENBAUM. I thank you. Thank you very much, Mr. Rule.

Mr. RULE. Thank you, sir.

[Prepared statement and response to questions follow:]

STATEMENT OF

CHARLES F. RULE
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

BEFORE THE

SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

S. 567,

THE "MALT BEVERAGE INTERBRAND COMPETITION ACT"

ON

AUGUST 4, 1987

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear today on behalf of the Department of Justice in opposition to S. 567, the "Malt Beverage Interbrand Competition Act." This bill is virtually identical to bills that were introduced during the last three Congresses, and to which the Department has consistently expressed strong opposition. 1/ As observed by Senator Thurmond, this bill would create an unnecessary and unwise special antitrust rule applicable to the malt beverage industry that is "bad for the law, bad for competition and bad for consumers." 2/

The bill's stated purpose is "[t]o clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws." Section 2 of the bill provides that the federal antitrust laws shall not render unlawful written exclusive territorial agreements involving

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1/ See, e.g., Testimony of Charles F. Rule, Acting Assistant Attorney General, Antitrust Division, U.S. Department of Justice, before the Senate Committee on the Judiciary concerning S. 412 (May 14, 1985); Testimony of William F. Baxter, Assistant Attorney General, Antitrust Division, U.S. Department of Justice, before the Senate Committee on the Judiciary concerning S. 1680 (November 7, 1983); Testimony of Abbott B. Lipsky, Jr., Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice, before the Senate Committee on the Judiciary concerning S. 1215 (June 21, 1982).

2/ 132 Cong. Rec. S.14258-59 (Sept. 30, 1986, daily ed.)

malt beverages, so long as the malt beverages covered by such agreements are in "substantial and effective competition" with other malt beverage products within a defined geographic area. Section 3 provides that the bill shall not be construed as legalizing enforcement of such exclusive territorial arrangements by means of "price-fixing agreements, horizontal restraints of trade, or group boycotts, if such agreement, restraints, or boycotts would otherwise be unlawful."

S. 567 is unnecessary because the courts, as well as the antitrust enforcement agencies, already have adopted a sound economic approach to analyzing vertical territorial arrangements among manufacturers and distributors under the antitrust laws. Under this approach, such an agreement cannot be condemned under the antitrust laws without a strong showing of likely consumer harm. Thus, the antitrust laws are posing no barrier to these generally procompetitive arrangements.

S. 567 is unwise because it would establish a special, but unclear, antitrust standard for vertical territorial arrangements in the malt beverage industry. The Department of Justice generally opposes the creation of industry-specific antitrust rules. Moreover, this is an industry with structural characteristics that clearly require sound antitrust scrutiny of vertical as well as horizontal agreements, unhindered by special-interest legislation of this type.

Finally, S. 567 is objectionable because of the confusion it would engender in an area of antitrust law that is becoming settled in a manner fully consistent with the promotion of consumer welfare--the proper object of the antitrust laws.

S. 567 is Unnecessary

The Department and the courts have long recognized that exclusive territorial arrangements and other non-price vertical restraints generally promote economic efficiency and therefore have beneficial effects on consumer welfare in a wide range of market settings. Such arrangements can be used to encourage distributor expenditures on product promotion, quality control, and point-of-sale services that enhance the value and reputation of the product. As a result, such arrangements can increase sales and intensify interbrand competition.

Vertical territorial restraints discourage harmful "free rider" behavior. If several distributors sell a manufacturer's product in a given geographic market, they all benefit from its enhanced reputation and the associated increase in sales induced by the expenditures of any one distributor. As a consequence, any given distributor captures only a fraction of the increased sales induced by its own promotional expenditures. A distributor therefore may well be reluctant to spend heavily so long as others are able to "free ride" on its efforts. The disincentives created by this free rider problem can result in too little expenditures in the aggregate on product promotion, quality control, or point-of-sale services. A manufacturer's decision to counter free rider problems through vertical territorial restraints thus generally has beneficial economic effects. 3/

At least since the Supreme Court's decision in GTE Sylvania, 4/ requiring a full "rule of reason" analysis of vertical restraints, exclusive territorial arrangements have been negotiated freely without fear of unreasonable antitrust condemnation. Under the case law, a non-price vertical restraint, such as an exclusive territory, need not be proven procompetitive to be found lawful; rather it is unlawful only if it is proven to harm consumer welfare (i.e., result in a long-term restriction of output in an appropriately defined market). Moreover, many cases applying the economic analysis required by GTE Sylvania have recognized the economic benefits

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3/ For a more detailed discussion of the free rider phenomenon, see Posner, "The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision," 45 U. Chi. L. Rev. 1 (1977).

4/ Continental TV. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

that vertical territorial arrangements may provide. 5/ Indeed, brewers themselves often have exclusive territorial arrangements with their wholesalers. We are not aware that such arrangements wrongfully have been held unlawful under the antitrust laws, or even that they have been subject to disproportionate challenge as compared to such arrangements in other industries.

In sum, current antitrust enforcement policy and recent precedent regarding exclusive dealing arrangements is basically sound, and S. 567 is thus unnecessary.

5/ At least one appellate court has expressly recognized such benefits with respect to the malt beverage industry. In Del Rio Distributing, Inc. v. Adolph Coors Co., 589 F.2d 176 (5th Cir.), cert. denied, 444 U.S. 840 (1979), the Fifth Circuit upheld a jury verdict that Coors' exclusive territorial restrictions were reasonable because there was ample evidence showing that the territories "were essential to maintaining quality control and service in the retail market" and resulted in "a long-term effect of making each distributorship stronger, better able to compete with other brands and provide better service." 589 F.2d at 179. For additional post-GTE Sylvania cases recognizing the beneficial effects of vertical territorial arrangements, see, e.g., Mendelovitz v. Adolph Coors Co., 693 F.2d 570 (5th Cir. 1982); Donald B. Rice Tire Co. v. Michelin Tire Corp., 638 F.2d 15, 16 (4th Cir. 1981), cert. denied, 454 U.S. 864 (1981); Red Diamond Supply, Inc. v. Liquid Carbonic Corp., 637 F.2d 1001, 1006 (5th Cir. 1981), cert. denied, 454 U.S. 827 (1981); Cowley v. Braden Industries, Inc., 613 F.2d 751, 755 (9th Cir. 1980), cert. denied, 446 U.S. 965 (1980); Abadir & Co. v. First Mississippi Corp., 651 F.2d 422, 426-28 (5th Cir. 1981); Davis-Watkins Co. v. Service Merchandise, 686 F.2d 1190, 1200-1201 (6th Cir. 1982); Service Merchandise Co., Inc. v. Amana Refrigeration, Inc., cert. denied, 104 S. Ct. 1718 (1984); Continental TV. Inc. v. GTE Sylvania, Inc., 684 F.2d 1132, 1136-39 (9th Cir. 1982); Newberry v. Washington Post Co., 438 F. Supp. 470, 475-76 (D.D.C. 1977).

S. 567 Could Significantly Harm Consumers

A special antitrust standard by which to judge exclusive territorial agreements in the malt beverage industry along the lines of that arguably contained in S. 567 is particularly undesirable because of that industry's peculiar characteristics. Although generally procompetitive, non-price vertical restraints can have anticompetitive effects in particular circumstances, for example by facilitating collusion among distributors. Widespread use of exclusive territories by all or most manufacturers may reduce substantially the total number of distributors of competing manufacturers in a given geographic area, thereby increasing the likelihood of successful collusion among those distributors. 6/

In the great majority of industries, the structural characteristics of production and distribution significantly reduce the likelihood that exclusive territories can or will lead to collusion. Thus, even with widespread use of exclusive territories, effective collusion likely would not occur if distributor concentration were low or entry into manufacturing

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6/ While manufacturers would generally seek to avoid such collusion as it increases wholesale prices and markups while reducing manufacturers' sales and profits, they might attempt to facilitate distributor collusion if they believed that they could share in the higher profits earned by colluding distributors.

were easy. If collusion were attempted, an existing manufacturer or a new entrant would have a strong incentive to exploit the opportunity for additional sales by undercutting the high, collusive prices of other manufacturers, especially where such undercutting is unlikely to be easily detected.

Unfortunately, the malt beverage industry appears to be one of the few in which the widespread use of exclusive territories carries some risk of facilitating collusion. Three conditions are necessary (though not sufficient) in order for territorial exclusives to carry such a risk: (1) high concentration in the manufacturing (i.e., brewing) market; (2) assignment of exclusive territories to distributors accounting for a large proportion of the sales in their markets; and (3) difficulty of entry into the manufacturing (i.e., brewing) level. All of these conditions exist today in the malt beverage industry.

First, concentration at the brewer level is high. In 1986, the top two brewers had a combined national sales share of 58.9 percent and the top four had a 79.6 percent share. 7/ Brewer concentration at the state level often has been significantly

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7/ Brewers Digest (Feb. 1987). These figures represent increases over the 1984 levels, which were 55 percent for the top two brewers and 76.8 percent for the top four. Id. (Feb. 1985).

higher than national concentration. For example, in 1982 the four-firm concentration ratio exceeded 80 percent in 28 of the 37 states for which data was available. 8/

Second, we understand that virtually all brewers use exclusive territorial arrangements, and that distributors account for virtually all sales in the market. Because different brewers utilize the same distributor in many markets, distributor concentration may even exceed concentration at the brewer level. 9/

Third, entry into brewing is not easy, in part because prospective entrants may encounter significant difficulties in

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8/ In five of the states the four-firm concentration ratio exceeded 90 percent, in 28 it exceeded 80 percent, in 35 it exceeded 75 percent, and in 37 it exceeded 65 percent. The identity of the four leading brewers differed in some states. These high state-level concentration figures were essentially unchanged from 1980 levels. See Steinman's Beer Statistics News, April 1981, March 1983.

At the brewer level, markets are relatively complex and producers in particular relevant markets may be located in several states. At the wholesale level, however, states often are the upper limit in the size of the market because state regulations generally prohibit sales by out-of-state distributors. Distribution markets might be as small as a particular metropolitan area, and it is at the distribution level that concern about collusion is greatest.

9/ While territories awarded by different brewers may not overlap perfectly, thereby increasing somewhat the number of distributors in those markets, distributor concentration nevertheless appears to be high.

establishing distribution channels. This is primarily due to state regulations that usually prohibit vertical integration by brewers into distribution and place licensing requirements on entry by independent distributors.

As a result of these special circumstances, exclusive territories raise competitive concerns in the malt beverage industry. I stress that we are not claiming that exclusive territories currently (or even in the future will) harm competition in this industry. Nevertheless, there is at least as much reason for antitrust scrutiny of exclusive distributorships in the malt beverage industry as in virtually any other industry.

Our concerns about the potential adverse effects of this legislation on competition in the malt beverage industry are not merely theoretical. Our recent experience in uncovering and prosecuting price-fixing and other anticompetitive agreements in the soft-drink industry supports those concerns. That industry possesses many of the same relevant market characteristics as the malt beverage industry, including high concentration at the manufacturing and distribution levels and pervasive use of exclusive territorial distributional agreements.

The Department currently has 12 ongoing grand jury investigations into collusion in the soft drink industry. Although most of our investigations are at an early stage, we have obtained four convictions and pleas, which have resulted in substantial fines and jail sentences for offenses that have occurred within the past 5 years. 10/ These investigations are expanding, and the emerging evidence suggests that the indictments and convictions we have obtained to date are indicative of widespread antitrust violations in the soft drink industry. Given this experience in an industry similar to malt beverages that received an antitrust dispensation largely identical to that contemplated by S. 567, relaxing antitrust safeguards against collusion in the malt beverage industry is simply not a good idea.

We do not believe that section 3 of the bill alleviates our concerns with its possible harmful effects. Section 3 apparently is intended to make clear that the bill is not to be interpreted as authorzing enforcement of exclusive territorial agreements by means of "price-fixing agreements, horizontal restraints of trade, or group boycotts" that otherwise would be

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10/ We are also aware of private litigation in which a jury recently found that a major bottling company conspired to fix retail prices and to divide markets. Sun-Drop Bottling Company, Inc. *et al.* v. Coca-Cola Bottling Co. Consolidated, D-C-84-513-M (D.N.C. filed June 4, 1986).

unlawful. The fact that courts could still condemn actual collusion were it to occur under the standards of the bill does not negate the need for them to be able to find exclusive territorial arrangements unlawful under the antitrust laws as currently interpreted in those admittedly very rare circumstances in which such arrangements are likely to facilitate collusion and thereby pose a threat to consumer welfare. Because section 3 does not diminish the bill's possible adverse effect on the courts' ability to find such exclusive arrangements unlawful in appropriate circumstances, it does not alleviate our concerns about S. 567.

S. 567 Will Create Confusion

Our greatest concern with S. 567 is that, rather than clarifying antitrust law, it will create confusion that may increase the legal uncertainty associated with using vertical restraints in other industries.

Under S. 567 exclusive territorial arrangements would be deemed lawful so long as the product was in "substantial and effective competition" with other malt beverages within a defined geographic area. The term "substantial and effective competition" is not defined in the bill, and its meaning is unclear. Also unclear is which party would have the burden of establishing the presence or lack of such competition, how it is to be measured, or how much "substantial and effective competition" is necessary in order to satisfy the bill's requirements if significant anticompetitive effects were to be shown. Nor is it clear at what level or levels of production and distribution "substantial and effective competition" must be present in order for the bill's standard to be applicable.

S. 567 might even be construed, incorrectly we believe, to imply that exclusive territorial agreements are less legitimate in other industries and thereby impose a more stringent standard on them, a result about which we would be most concerned. Accordingly, it is important that the flexibility of the well-understood, widely-interpreted and generally applicable existing antitrust standard remain for such arrangements in this industry as it is in virtually all others. 11/

11/ We recognize that the Soft Drink Interbrand Competition Act, 15 U.S.C. §§ 3501-03, enacted during the 96th Congress, is similar to S. 567. The Department of Justice objected to passage of that Act, among other reasons, for fear that it might be interpreted as creating a standard of legality for vertical territorial arrangements in the soft drink industry different from that contained in section 1 of the Sherman act. Indeed, at least two courts have so held, *see* Commonwealth of Pennsylvania *ex rel*. Zimmerman v. PepsiCo., Inc. *et al.*, (M.D. Pa.), *appeal docketed*, No. 87-535 (3d Cir. 1987) (action dismissed on holding that the Soft Drink Act created a new standard for assessing vertical territorial agreements); Coca-Cola Co. v. FTC, 642 F.2d 1387 (D.C. Cir. 1981) (action remanded based on different legal standard). Enactment of S. 567 poses the same risk.

In sum, special interest antitrust legislation along the lines of S. 567 is unnecessary and unwise. The Department of Justice strongly recommends against its enactment.

Mr. Chairman, that concludes my prepared remarks. I would be happy to answer any questions you or any members of the Subcommittee may have.

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U.S. Department of Justice

Office of Legislative and Intergovernmental Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

September 9, 1987

Honorable Howard M. Metzenbaum
Chairman, Subcommittee on Antitrust,
  Monopolies and Business Rights
Committee on the Judiciary
United States Senate
Washington, D.C. 20510-6275

Dear Mr. Chairman:

I am writing this letter in response to two letters recently received by Charles F. Rule, Assistant Attorney General, Antitrust Division, requesting answers to questions raised by his August 4, 1987, testimony concerning S. 567, the "Malt Beverage Interbrand Competition Act." The first is an August 7, 1987 letter from you, enclosing questions from Senator Hatch. The second is an August 7, 1987, letter from Senator DeConcini. I am pleased to enclose Mr. Rule's answers to these questions. If I can be of any further assistance during the Subcommittee's consideration of S. 567, please do not hesitate to contact me.

Sincerely,

John Bolton (by LN)

John R. Bolton
Assistant Attorney General

Enclosures

cc: Senator Dennis DeConcini
    Senator Orrin G. Hatch

QUESTIONS FOR MR. RULE FROM SENATOR HATCH REGARDING S. 567

Question 1. Mr. Rule, you have raised some new information regarding litigation within the soft drink industry relating to allegations of price fixing. I would very much like to examine these cases in some detail. However, with regard to the relevance of these cases to the bill before us, S. 567, it is my understanding that this bill clarifies the application of the rule of reason as it applies to exclusive territories. This bill does not affect in any way the ability of the Department to bring charges of price fixing, horizontal restraints of trade, or group boycotts. Is that your reading of section 3 of S. 567?

Answer. With respect to the first part of your question, the Department, of course, cannot comment in any detail concerning our ongoing grand jury investigations of anticompetitive horizontal agreements in the soft drink industry. I am, however, enclosing copies of the indictments that have been returned to date in this area for your consideration. As I noted in my testimony, it appears that anticompetitive agreements in the soft drink industry, which has many structural parallels to the malt beverage industry, may be widespread.

The main thrust of your question is whether passage of S. 567 would impede the Department's ability to investigate or prosecute anticompetitive horizontal agreements in the malt beverage industry should any currently exist or arise in the future. My answer, based on our experience with the "Soft Drink Interbrand Competition Act," is that S. 567 is unlikely to prove an impediment to criminal enforcement efforts against only *per se* unlawful horizontal conspiracies in the malt beverage industry.

Of greater concern is that S. 567 may prove to be an impediment to the Department's ability to challenge the legality of exclusive territorial agreements in the malt beverage industry should we determine that it is necessary to do so. As I noted in my testimony, the malt beverage industry is one whose structure makes it perhaps more likely than in most other industries that vertical territorial restraints could have the effect of facilitating horizontal collusion.

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Unfortunately, despite the best efforts of the Department, there is no guarantee that any such collusion would be promptly detected or successfully prosecuted. Under the rule of reason, the Department could challenge vertical territorial arrangements if we determined that their facilitation of anticompetitive horizontal collusion outweighed their procompetitive benefits. Should S. 567 be enacted, however, we could be required to prove, either in addition to or instead of the rule of reason standard, the absence of "substantial and effective competition" with other malt beverage products. Adoption of this new and undefined standard would certainly complicate any such litigation that the Department might undertake. Because we believe that the existing rule of reason standard is both clear and appropriate, we cannot support enactment of S. 567.

Question 2. There have been allegations by critics of this legislation that this bill uses federal power to restrict competition through exclusive territory licensing of distributors. This allegation confuses me. It is my understanding that this legislation allows the states to continue regulating malt beverages the way they have done for the past half century. State law that either prohibits exclusive territories or specifically requires exclusive territories is not altered by this legislation. Is that correct?

Answer. The interaction of the federal antitrust laws and state laws regulating the distribution and sale of alcoholic beverages is often complex, involving as it does issues of federal preemption, see, e.g., Rice v. Norman Williams Co., 458 U.S. 654 (1982), the state-action doctrine, see California Liquor Dealers v. Midcal Aluminum, Inc., 445 U.S. 97 (1980), and the 21st Amendment, see 324 Liquor Corp. v. Duffy, 107 S. Ct. 720 (1987). There is, however, nothing in S. 567 that appears to alter this relationship. The Supreme Court has held, in the Rice case noted above, that the federal antitrust laws do not broadly preempt state laws permitting distillers to impose non-price vertical restraints on their wholesalers, and the disclaimer in section 7 of S. 567 of any congressional intent to invalidate or affect any provision of the laws of any State would appear to protect state laws prohibiting such restraints as well. Thus, I do not believe that the passage of S. 567 would alter the present rights of states to regulate the distribution of malt beverages.

Question 3. Proponents of this legislation argue that the antitrust laws governing the use of exclusive territories in the malt beverage industry are unclear and burdensome. They cite recent case law such as the Continental TV, Inc. v. GTE Sylvania, Inc. case, to support their concern that a legislative clarification is needed. Do you disagree with the concern that legal uncertainty characterizes the use of vertical distribution practices, such as exclusive territorial franchises?

Answer. I do disagree that the law governing the use of non-price vertical restraints, such as exclusive territorial franchises, is in any need of legislative clarification. Since Justice Powell's decision a decade ago in the GTE Sylvania case, the potential procompetitive benefits of such vertical restraints have been consistently recognized and affirmed by the courts. Hence, these types of vertical agreements are judged under the antitrust rule of reason and may be invalidated only if they are found after careful scrutiny to harm consumer welfare by restricting output in a correctly defined market. While the rule of reason standard might be misapplied in a given factual situation, the same surely would be true of the "substantial and effective competition" standard found in S. 567. As I noted in my testimony, we are not aware of instances where the rule of reason has been misapplied with respect to vertical territorial arrangements in the malt beverage industry.

QUESTIONS FOR MR. RULE FROM SENATOR DeCONCINI REGARDING S. 567

Question 1. In 1985, you testified before this subcommittee on an identical bill. You were asked whether you had any evidence which would indicate that beer prices are higher in states with exclusive territories than those without. Your response, which appears on page 14 of those printed hearings, states, "... we simply have not seen a study that we are willing to say indicates an increase in price after the introduction of exclusive distributorship." The New York Consumer Survey, which alleged a 35% increase in beer prices was made part of the same record.

a. Do your general comments apply to this study in particular?

Answer. I had not reviewed the New York Consumer Survey at the time of my prior testimony.

b. In case you did not look at the New York Consumer Survey at the time of the 1985 hearing, have you reviewed the study since? Does that study suffer from the same analytical flaws of other studies you discussed in 1985, or is it of better quality?

Answer. Having now reviewed the New York Consumer Survey, we find that it has a number of shortcomings. Apparently, no attempt was made to determine the causes of wholesale price changes in any scientific manner. For example, the study did not attempt to control for changes in distributors' costs, such as prices charged by brewers and the costs of providing distribution services including handling returnable bottles. Neither did the study attempt to account for changes in product and service quality that may have been the result of changes in distribution practices. In fact, it did not examine wholesale prices at all, but relied instead on an examination of retail prices.

In any event, the study is not properly interpreted as providing substantial evidence of an effect of exclusive territories on prices. The study finds a substantial increase in beer prices between 1982 and 1985 and a much smaller increase in soft drink prices. While one might infer from this that exclusive territories in the beer industry were the explanation for these results, such an inference would not be justified. Essentially the entire increase in beer prices over the period examined occurred at a single point in time--September 1983. Exclusive territories are not a likely explanation for this, since they were imposed earlier in the year. September 1983, however, was the time at which the New York returnable container law was implemented, and it is a more likely explanation for the one time jump in beer prices than exclusive territories. Whether such was actually the case is not clear; other causes are certainly possible.

c. Does a survey of retail prices, such as the New York study, necessarily indicate anything about wholesale prices?

Answer. Retail prices are, of course, only an indirect indicator of wholesale prices. Without knowing a great deal about the relationship between the two and about possible independent causes of changes in retail prices, little about changes in wholesale prices can be inferred from studying retail price changes.

d. Please review and submit your written comments about the wholesale price survey completed by Grant Thorton. (See Attached).

Answer. The study by Grant Thorton for New York appears to be far superior to the New York Consumer Survey because it attempts to determine the extent to which price increases were the result of cost increases. On the other hand, it is not possible to determine whether cost increases were properly measured. The cost data appear to be rather rough, and there is no explanation of their source. No attempt appears to have been made to analyze prices and costs for particular brands or to correlate the results of such an analysis with distribution practices. In addition, there is no examination of changes in product or service quality that resulted from changes in distribution practices. The most the study can be said to prove is that prices moved roughly the same amount as costs. The roughness of the cost data leaves open the possibility that exclusive territories raised prices somewhat or lowered prices somewhat.

The Thorton study for Alabama and Missouri is less helpful than that for New York. It only shows that, during a period of several years before and after the time that these states passed exclusive territory laws, wholesale beer prices changed little and followed the consumer price index for beer and ale. At best, these results prove that the effects of exclusive territories were rather modest.

Question 2. In your prepared statement for the 1985 hearing you stated, at page 23 of the printed hearing, that the "... Department maintains that exclusive territorial arrangements should be prohibited only where their effect may be substantially to restrain competition among competing independent brands and that the appropriate focus of the antitrust laws should be the effect of restraints on interbrand as opposed to intrabrand competition." (Emphasis added.)

Opponents of this bill contend that the only way consumers can benefit is if there is substantial competition among dealers of the same brand-name product as opposed to competition among different brands. Your 1985 testimony seems to view interbrand competition as the principal defender of consumers' interest. Is this correct? Please comment.

Answer. I continue to believe that the focus of the antitrust laws in this area should be the effect of exclusive territorial restraints on interbrand competition. Apart from antitrust constraints, manufacturers generally would have an incentive to adopt practices, including practices with respect to distribution, that reduce interbrand competition. Reducing interbrand competition causes prices and profits to rise at the expense of consumers. For precisely this reason, the antitrust laws protect interbrand competition. One might assume that the exact same rationale applies to intrabrand competition, but such is not the case. If reductions in intrabrand competition also reduce interbrand competition, then manufacturers desire them and society does not. However, when reductions in intrabrand competition do not affect interbrand competition, this conflict between the manufacturer's interest and the consumer's interest generally does not exist. Generally, a manufacturer will unilaterally choose to reduce intrabrand competition precisely because that is what consumers want and by better satisfying consumer wants the manufacturer can increase its profits.

Let me make clear, if I have not already done so, that the Department's opposition to S. 567 is in no way based on

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hostility to vertical exclusive territorial restraints in general. I believe that the rule of reason standard under which such restraints are currently judged is both clear and appropriate and is not in need of legislative "clarification." Further, given the particular structure of the malt beverage industry, vertical territorial restraints in that industry may be somewhat more likely than in other industries to facilitate horizontal (interbrand) agreements in restraint of trade. Because S. 567 can be read to provide enhanced protection from antitrust challenge to vertical territorial restraints in the malt beverage industry, it would be particularly inappropriate for Congress to enact this legislation.

Question 3. The presence of effective and substantial interbrand competition is the benchmark used in S. 567. Is your opposition to S. 567 based on this measurement?

Answer. As I testified, the Department's opposition to S. 567 is based principally on the fact that the standard that would be provided by section 2, "substantial and effective competition with other malt beverage products," is more likely to confuse than to clarify the present rule of reason standard for judging the legality under the antitrust laws of vertical territorial restraints in the malt beverage industry. The term itself is undefined, and a number of questions could arise as to its application, such as which levels of production or distribution in the malt beverage industry are to be looked to in making the required determination. As I note in my answer to Question 10, the rule of reason standard to be applied to vertical territorial restraints is readily understood, clearly appropriate and in no particular need of legislative clarification, even if such clarification were possible. Thus, passage of S. 567 is unnecessary.

Question 4. Concerning the twelve ongoing grand jury investigations, is it not true that these investigations are based on price fixing violations and not vertical exclusivity agreements?

Answer. While I am not in a position to answer specific questions concerning ongoing grand jury investigations, the indictments that have been returned to date in the course of our continuing investigation of the soft drink industry have not included allegations based on vertical exclusive territorial agreements.

Question 5. Is there any hard evidence that exclusive territories by themselves caused prices to be fixed?

Answer. In light of the fact that vertical exclusive territorial agreements have been extensively used in the soft drink industry for the last 75 years, we would not expect to uncover, nor have we uncovered, direct cause-and-effect type evidence that these agreements resulted in fixed prices for soft drinks. We have, however, seen evidence that parties to price-fixing agreements understood that they did not have to worry about transshipments of soft drinks eroding their price-fixing efforts because of the existence of exclusive territories. This is consistent with our view that vertical exclusive territorial restraints may facilitate horizontal collusion under certain circumstances, though it does not prove that such collusion would not have occurred in the absence of such restraints.

Question 6. In your written statement you suggested that the availability of exclusive territories will substantially reduce the total number of distributors in a given area and increase the likelihood of collusion. Are you aware of the facts in Indiana? Prior to exclusive territories being prohibited, Indiana had approximately 220 wholesale distributors of malt beverage. Following the adoption of legislation prohibiting such agreements the number of wholesalers has dropped to 100. Do not these statistics suggest the opposite result from your conclusion?

Answer. Although the Department has not studied the situation in Indiana, we can suggest that there are any number of reasons why the number of distributors may increase or decrease, and exclusive territories is but one. The decline in the number of distributors in Indiana might have been even greater without the state ban on exclusive territories. One possible explanation is that exclusive territories were used to deal with severe free-rider problems. It may be that when exclusive territories were prohibited, brewers had to find

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another method for dealing with the free-rider problem. One method is a drastic reduction in the number of distributors. Fewer distributors yield less free riding. Whether this is actually true of the Indiana experience is not known to the Department.

It clearly is the case, however, that exclusive territories can be used to reduce the number of distributors if brewers so choose, which is the primary point that I was trying to make.

Question 7. In your statement you say that the likelihood of collusion is enhanced when there are high barriers to entering the market. There you were referring to entering the market at the manufacturing level. This bill, however, concerns the wholesaler level. The Tollison study shows that the entrance barriers to the wholesale industry are low. Does not the fact that the barriers to the wholesale industry are low tend to support the proposition that the chances of collusion by wholesalers will be small?

Answer. We are not certain that barriers to entry into the wholesale tier of the beer industry will always be low. Entry into distribution of malt beverage products is regulated by the states, and state licensing procedures may not always permit entry in response to competitive demands. The Tollison study does not address the impact of regulatory barriers on entry into beer wholesaling.

In addition, one scenario of distributor collusion is a distributor cartel aided and abetted by brewers, which collect a substantial fraction of the cartel profits through some sort of fee or possibly through increased prices. Under this scenario, barriers to entry into distribution are irrelevant. The exclusive territories themselves act as the barrier to entry. The brewers simply would adhere to their contractual obligations and refuse to deal with entering distributors that threatened the cartel.

Question 8. In your statement you say that wholesalers have not been subject to a "disproportionate" number of challenges to exclusive territories. How many have there been? What is the effect on the wholesalers who have to pay the costs to defend these unjustified suits? In reality, is it not the consumer who pays the price for the unjustified litigation through higher taxes and higher beer prices?

Answer. We have not compiled any statistics on the number of lawsuits that have been brought challenging exclusive territorial agreements. However, no evidence has come to our attention concerning disproportionate numbers of challenges to such agreements, and we have no reason to believe that they exist. In addition, whether an exclusive territorial restraint is unlawful depends, under the rule of reason, on the circumstances of the case at hand. Of course, not every challenge to such a restraint, nor even every losing challenge, is "unjustified."

At the present time, one of the biggest problems with "unjustified" challenges to nonprice vertical restraints, such as exclusive territorial restraints, is that they can so easily be mischaracterized as per se unlawful price-related vertical restraints. The courts appear to be making steady progress in resolving this problem, and the Supreme Court may provide further help when it decides the Sharp Electronics case next term (see answer to Question 10).

Another problem that increases the likelihood of unjustified cases being brought against vertical territorial restraints is the availability of treble damages. As you know, at the current time plaintiffs are entitled to sue for treble damages regardless of the nature of the antitrust injury that they allege. While treble damages clearly are appropriate for conduct that is certain to cause economic harm, so that maximum deterrence is needed, treble damages can be counterproductive when permitted against conduct whose competitive nature is uncertain and that is subject to being mischaracterized, as are many types of vertical restraints. It also happens that conduct in this latter category is most often challenged by competitors rather than by consumers or customers. Unfortunately, competitors have a perverse incentive to challenge conduct that is aggressively competitive since competition hurts them while benefiting consumers. These unjustified actions are further encouraged by the prospect of recovering treble damages. In any event, the prospect of being required to pay unwarranted treble damages may well inhibit certain types of competitive behavior.

The types of problems that I have described are more likely to raise challenges to vertical territorial agreements in the malt beverage industry than is possible confusion concerning the application of the rule of reason, but they are not addressed by S. 567. Indeed, these problems are pervasive, inhibiting many types of procompetitive business arrangements. The Administration has proposed, and the Subcommittee has before it for consideration, legislation that could be of significant benefit to companies facing unjustified antitrust challenges for potentially procompetitive conduct, including malt beverage wholesalers. The "Antitrust Remedies Improvements Act of 1987," sections 4112-17 of S. 539, the "Trade, Employment, and Productivity Act of 1987," would correct the treble-damage problem as well as provide attorneys' fees to a substantially prevailing defendant in an antitrust action upon a finding that the plaintiff's conduct was frivolous, unreasonable, without foundation, or in bad faith. I urge you to consider this broad remedial legislation in preference to the narrow approach taken in S. 567.

It is, of course, very likely that litigation costs will be paid by consumers and taxpayers in most circumstances. There are, however, situations in which shareholders may end up paying.

Question 9. You have stated that the "substantial and effective competition" clarification to the rule of reason would create greater confusion. This clarification is the same one used in the Soft Drink Beverage Act of 1980. Has this clarification in the soft drink industry caused great confusion? What does the holding in the Pepsico case you cited demonstrate regarding this clarification?

Answer. I do not believe that any confusion exists at the current time with respect to the proper antitrust standard to be applied to vertical exclusive territorial agreements.

S. 567 would replace the tried-and-true rule of reason standard with a new, undefined and uncertain standard for judging the legality of such agreements in the malt beverage industry, just as was done for the soft drink industry in the Soft Drink Interbrand Competition Act.

Shortly after passage of the Soft Drink Interbrand Competition Act, the D.C. Circuit remanded the FTC's Coca-Cola decision for dismissal on the basis that that Act had created a new standard for judging the legality of vertical exclusive territorial restraints in the soft drink industry. The court did not, however, address the issue of what that new standard might be. Coca-Cola Co. v. FTC, 642 F.2d 1387 (D.C. Cir. 1981). The district court in PepsiCo appears to have found certain vertical territorial restraints to have been rendered per se lawful by the Act without any discussion of the "substantial and effective competition" proviso. Pennsylvania ex rel. Zimmerman v. PepsiCo, Inc., 658 F. Supp. 816 (M.D. Pa.), appeal docketed, No. 87-535 (3d Cir. 1987). Thus, insofar as these two cases are concerned, it would appear that, rather than merely clarifying the standard to be used to judge vertical territorial restraints in the soft drink industry, Congress adopted a new and as yet uncertain standard. During congressional consideration of the Soft Drink Interbrand Competition Act, the Department strongly expressed the view that there was no need for a new standard in the soft drink industry; likewise, we find no such need with regard to malt beverages.

Question 10. Under current judicial interpretation, how clear is the "rule of reason"? If the standard is clear, why has the Supreme Court decided to once more consider this rule next term in Business Electronics Corp. v. Sharp Electronics Corp.?

Answer. The Supreme Court has made it clear that the rule of reason requires an inquiry carefully structured to include only those factors necessary to an informed judgment about the competitive significance of a particular restraint. See

National Collegiate Athletic Assoc. v. Board of Regents, 468 U.S. 85, 103-113 (1984). The Court has also described at length the procompetitive potential of vertical nonprice restraints, such as territorial allocations, thus affording the lower courts extensive guidance in evaluating such arrangements under the rule of reason. See Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984); Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

The Supreme Court has granted certiorari in Business Elec. Corp. v. Sharp Elec. Corp. (Sup. Ct. No. 85-1910) (cert. granted, June 8, 1987) to consider whether a supplier's agreement with a retailer to terminate another retailer for cutting prices is a per se violation of the Sherman Act, in the absence of an agreement to set resale prices. Thus, the Supreme Court will determine whether such price-related vertical agreements are illegal per se or whether they require rule of reason analysis. That is, the issue is not how to apply the rule of reason analysis, but whether it should be applied at all. S. 567 is not directed to clarifying such initial characterization issues. Furthermore, the issue of the appropriate analytical standard has already been settled with respect to vertical territorial agreements in Continental T.V., Inc. v. GTE Sylvania, Inc., supra.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA)
v.)
GENERAL CINEMA BEVERAGES OF WASHINGTON, D.C., INC.,)
Defendant.)

OCT 15 1986

Criminal No. CR86-0352
Judge Revercomb

INFORMATION

The United States of America, acting through its attorneys, charges:

I.

DEFENDANT

1. General Cinema Beverages of Washington, D.C., Inc. ("General Cinema Beverages") is made a defendant herein. General Cinema Beverages is a corporation organized and existing under the laws of the State of Delaware and has its principal place of business in Cheverly, Maryland. During the period of time covered by this Information, General Cinema Beverages was engaged in the soft drink business in the District of Columbia.

2. Whenever in this Information reference is made to any act, deed or transaction of any corporation, such allegation shall be deemed to mean that said corporation engaged in such act, deed or transaction by or through its agents, employees or representatives while they were actively engaged in the management, direction, control or transaction of its business or affairs.

II.

CO-CONSPIRATORS

3. A firm and various individuals, not made defendants herein, participated as co-conspirators in the offense charged herein and performed acts and made statements in furtherance thereof.

III.

TRADE AND COMMERCE

4. The manufacture, distribution and sale of soft drinks

(meaning a nonalcoholic, flavored and carbonated beverage) involve several levels of commercial activity:

(a) national manufacturers produce soft drink concentrate or syrup which they sell to local soft drink bottling companies;

(b) soft drink bottling companies mix the concentrate or syrup with carbonated water and other ingredients to make soft drinks which are then packaged in cans, bottles and other dispensing containers;

(c) soft drink bottling companies, such as General Cinema Beverages, distribute and sell soft drinks to retail food, convenience, drug, liquor and mass merchandise stores; hotels, motels, schools and other institutions; and companies that lease or own vending machines; and

(d) consumers purchase soft drinks from the customers of General Cinema Beverages and other soft drink bottling companies.

5. General Cinema Beverages and other soft drink bottling companies frequently issue and distribute what are called "promotional letters" that describe prices and discounts offered for certain time periods to customers for various soft drink packages.

6. During the period of time covered by this Information, General Cinema Beverages and a co-conspirator bottling company conducted business in the Metropolitan Washington, D.C. Area, meaning the District of Columbia and those areas of Maryland and Virginia served by both companies.

7. During the period of time covered by this Information, substantial quantities of soft drink concentrate and syrup used to make soft drinks, as well as soft drink cans, bottles and other packaging materials, were shipped from outside the State of Maryland, in a continuous and uninterrupted flow of interstate commerce, to General Cinema Beverages production facilities in Maryland, for use in the bottling and sale of

soft drinks in the Metropolitan Washington, D.C. Area.

8. During the period of time covered by this Information, substantial quantities of soft drinks produced by General Cinema Beverages production facilities in Maryland were shipped from those facilities to customers in the District of Columbia and the Commonwealth of Virginia in a continuous and uninterrupted flow of interstate commerce.

9. During the period of time covered by this Information, the activities of the defendant and co-conspirators, as charged herein, were within the flow of, and substantially affected, interstate commerce.

IV.

OFFENSE CHARGED

10. Beginning in or about October 1984, the exact date being unknown to the United States, and continuing thereafter until August 31, 1985, the defendant and co-conspirators engaged in a combination and conspiracy in unreasonable restraint of the above-described interstate trade and commerce, in violation of Section 1 of the Sherman Act, 15 United States Code § 1.

11. The aforesaid combination and conspiracy consisted of a continuing agreement, understanding and concert of action among the defendant and co-conspirators, the substantial term of which was to fix the price of Pepsi-Cola and Coca-Cola cola soft drink products in the Metropolitan Washington, D.C. Area by: (a) agreeing to adhere to prices published in promotional letters, and (b) agreeing to a wholesale price increase for 12-ounce cans that became effective in July 1985.

12. For the purpose of forming and effectuating the aforesaid combination and conspiracy, the defendant and co-conspirators did those things that they combined and conspired to do, including, among other things:

(a) meeting and discussing adherence to promotional letter prices;

(b) meeting and discussing an increase of the wholesale price of 12-ounce cans of Pepsi-Cola and Coca-Cola cola soft drink products;

(c) agreeing to adhere to promotional letter prices;

(d) agreeing to fix and increase the wholesale price of 12-ounce cans of Pepsi-Cola and Coca-Cola cola soft drink products that became effective in July 1985; and

(e) monitoring and enforcing the agreement to adhere to promotional letter prices.

V.

EFFECTS

13. The combination and conspiracy charged herein had the following effects, among others:

(a) prices of certain cola soft drink products sold by General Cinema Beverages and a co-conspirator soft drink bottling company in the Metropolitan Washington, D.C Area were fixed, raised and maintained at artificially high and noncompetitive levels;

(b) customers of the defendant and a co-conspirator soft drink bottling company in the Metropolitan Washington, D.C. Area were deprived of the opportunity to purchase certain cola soft drink products in an open and competitive market; and

(c) consumers of certain Pepsi-Cola and Coca-Cola cola soft drink products were deprived of the benefits derived from an open and competitive market at the wholesale level.

VI.

JURISDICTION AND VENUE

14. The aforesaid combination and conspiracy was carried out, in part, within the District of Columbia and within the five years preceding the filing of this Information.

Dated: October , 1986

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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
NORFOLK DIVISION

OCT 28 1986

UNITED STATES OF AMERICA)
)
v.) Criminal No. CR86-102-N
)
ARMAND GRAVELY,)
)
Defendant.)

OCTOBER 1986 TERM - AT NORFOLK, VIRGINIA

INDICTMENT

The Grand Jury charges:

COUNT ONE

I.

DEFENDANT

1. ARMAND GRAVELY is hereby indicted and made a defendant herein. During the period of time covered by this Indictment, Armand Gravely was Division Manager of the Richmond Division of Allegheny Pepsi-Cola Bottling Company (hereinafter referred to as "Allegheny Pepsi"). During the period of time covered by this Indictment, Armand Gravely, as Division Manager of Allegheny Pepsi's Richmond Division, was engaged in the soft drink beverage business in the Eastern District of Virginia.

2. Whenever in this Indictment reference is made to any act, deed or transaction of any corporation, such allegation shall be deemed to mean that said corporation engaged in such act, deed or transaction by or through its officers, directors, agents, employees or representatives while they were actively engaged in the management, direction, control or transaction of its business or affairs.

II.

CO-CONSPIRATORS

3. Various firms and individuals, not made defendants herein, participated as co-conspirators in the offense charged herein and performed acts and made statements in furtherance thereof.

III.

TRADE AND COMMERCE

4. The manufacture, distribution and sale of soft drinks

(meaning a nonalcoholic, flavored and carbonated beverage) involve several levels of commercial activity:

(a) national manufacturers produce soft drink concentrate or syrup which they sell to local soft drink bottling companies;

(b) soft drink bottling companies mix the concentrate or syrup with carbonated water and other ingredients to make soft drinks which are then packaged in cans, bottles and other dispensing containers;

(c) the soft drink bottling companies, such as Allegheny Pepsi, distribute and sell soft drinks to retail food, convenience, drug, liquor and mass merchandise stores; hotels, motels, schools and other institutions; and companies that lease or own vending machines; and

(d) consumers purchase soft drinks from the customers of Allegheny Pepsi and other soft drink bottling companies.

5. Allegheny Pepsi and other soft drink bottling companies frequently issue and distribute what are called "promotional letters" that describe discounts and prices offered for limited time periods to customers for certain soft drink packages.

6. During the period of time covered by this Indictment, Allegheny Pepsi and a co-conspirator soft drink bottling company conducted business in the Eastern District of Virginia through divisions headquartered in Norfolk and Richmond, Virginia.

7. During the period of time covered by this Indictment, substantial quantities of soft drink concentrate and syrup used to make soft drinks, as well as soft drink cans, bottles and other packaging materials, were shipped from outside the Commonwealth of Virginia, in a continuous and uninterrupted flow of interstate commerce, to the production facilities of Allegheny Pepsi and a co-conspirator soft drink bottling company in Virginia for use in the bottling and sale of soft drinks in the Norfolk and Richmond areas of Virginia.

8. During the period of time covered by this Indictment, a co-conspirator soft drink bottling company produced and shipped substantial quantities of soft drinks from outside the Commonwealth of Virginia in a continuous and uninterrupted flow of interstate commerce to facilities of that company in Virginia for sale in the Norfolk and Richmond areas of Virginia.

9. During the period of time covered by this Indictment, Allegheny Pepsi and a co-conspirator soft drink bottling company produced and shipped substantial quantities of soft drinks from their production facilities in Maryland and Virginia to their distribution facilities in other states for sale in those destination states in a continuous and uninterrupted flow of interstate commerce.

10. During the period of time covered by this Indictment, the activities of the defendant and co-conspirators, as charged herein, were within the flow of, and substantially affected, interstate commerce.

IV.

OFFENSE CHARGED

11. Beginning in or about February 1983 and continuing thereafter into at least the last quarter of 1984, the exact dates being unknown to the Grand Jury, the defendant and co-conspirators engaged in a combination and conspiracy in unreasonable restraint of the above-described interstate trade and commerce, in violation of Section 1 of the Sherman Act, 15 United States Code § 1.

12. The aforesaid combination and conspiracy consisted of a continuing agreement, understanding and concert of action among the defendant and co-conspirators, the substantial term of which was to fix the prices of soft drinks sold by Allegheny Pepsi and a co-conspirator soft drink bottling company in the areas of Virginia served by the Norfolk and Richmond divisions of both companies.

13. For the purpose of forming and effectuating the aforesaid combination and conspiracy, the defendant and co-conspirators did those things that they combined and conspired to do, including, among other things:

(a) participating in meetings and telephone conversations to discuss and agree upon promotional letter prices of soft drinks;

(b) agreeing to set certain minimum soft drink promotional letter prices and to increase promotional letter prices of certain soft drinks for Allegheny Pepsi and a co-conspirator soft drink bottling company in the Norfolk and Richmond areas of Virginia;

(c) instructing subordinate employees of Allegheny Pepsi to meet with representatives of a co-conspirator soft drink bottling company to exchange promotional letters and other information relating to prices;

(d) issuing promotional letters reflecting pricing agreements between Allegheny Pepsi and a co-conspirator soft drink bottling company;

(e) agreeing to adhere to promotional letter prices; and

(f) making efforts to enforce pricing agreements between Allegheny Pepsi and a co-conspirator soft drink bottling company.

V.

EFFECTS

14. The combination and conspiracy charged herein had the following effects, among others:

(a) prices of certain soft drink products sold by Allegheny Pepsi and a co-conspirator soft drink bottling company in the Norfolk and Richmond areas were fixed and raised; and

(b) customers of the defendant and co-conspirators in the Norfolk and Richmond areas were deprived of the opportunity to purchase certain soft drink products in an open and competitive market.

VI.

JURISDICTION AND VENUE

15. The aforesaid combination and conspiracy was carried

out, in part, within the Eastern District of Virginia and within the five years preceding the return of this Indictment.

COUNT TWO

The Grand Jury further charges:

1. Each and every allegation contained in paragraph 1 of Count One of this Indictment is here realleged with the same force and effect as though said paragraph was set forth in full detail.

2. On September 11, 1984, a duly impanelled grand jury in the Eastern District of Virginia was conducting an investigation of possible criminal violations of federal laws, including price fixing in the soft drink beverage industry in portions of Virginia and other areas.

3. On September 11, 1984, the grand jury issued subpoenas *duces tecum* to certain soft drink bottlers, among these Allegheny Pepsi, ordering the production of certain documents, including:

> (a) "All documents, including but not limited to notes, which relate to prices, discounts, market strategies or terms and conditions of sale of soft drinks by the Company or any other drink distributor"; and
>
> (b) "All documents which relate to meetings, discussions, conversations or other communications between one or more officers, directors, employees or agents of the Company with one or more officers, directors, employees or agents of any other soft drink distributor relating to prices, discounts, market strategies or terms and conditions of sale of soft drinks."

4. By agreement between counsel for Allegheny Pepsi and counsel for the United States, the documents pertaining to the Richmond Division of Allegheny Pepsi were to be held by Allegheny Pepsi for production at a later time upon request of the United States.

5. On April 18, 1985, the United States requested Allegheny Pepsi to produce those documents pertaining to its Richmond Division. The letter requesting the production specifically demanded the production of: ". . . all documents called for by the subpoena in Armand Gravely's files, without any limitation on geographic area or division of Allegheny Pepsi."

6. On August 26, 1985, the grand jury learned that a file containing business memoranda from Stan Fabian, Allegheny Pepsi's Division Manager in Norfolk, to Jerry Pollino, Allegheny Pepsi's Vice President of Sales, was or had been maintained by the defendant in connection with the business of Allegheny Pepsi. On that same date, the grand jury issued another subpoena duces tecum to Allegheny Pepsi demanding the production of those specific documents. The subpoena demanded, among other things: "The entire contents, including all file folders of all files maintained by or for Armand Gravely containing memoranda from Stan Fabian to Jerry Pollino."

7. Sometime after September 12, 1984, the exact date being unknown to the Grand Jury, the defendant, knowing of the existence of the grand jury investigation, willfully, knowingly and corruptly endeavored to influence, obstruct or impede the due administration of justice in the United States District Court for the Eastern District of Virginia by causing the destruction or concealment of certain memoranda from Stan Fabian to Jerry Pollino that were material to the grand jury's investigation.

8. The defendant had reason to believe and did believe that the grand jury had ordered or would order the production of the memoranda from Stan Fabian to Jerry Pollino, and the defendant caused the destruction or concealment of the memoranda for the purpose and with the effect of preventing disclosure of those documents to the grand jury, in violation of Title 18, United States Code, Section 1503.

COUNT THREE

The Grand Jury further charges:

1. Each and every allegation contained in paragraph 1 of Count One and paragraph 2 of Count Two of this Indictment is here realleged with the same force and effect as though said paragraphs were set forth in full detail.

2. On August 26, 1985, the grand jury learned that the defendant had made and maintained tape recordings of some of his telephone conversations with Randy Allen, Vice President and Division Manager in Richmond of Mid-Atlantic Coca-Cola Bottling Company, Inc., and Jerry Pollino, Vice President of Sales of Allegheny Pepsi, in connection with the business of Allegheny Pepsi.

3. On August 26, 1985, the grand jury issued a subpoena duces tecum to Allegheny Pepsi ordering, among other things, the production of: "All tape recordings, and documents relating to such recordings, of conversations between Armand Gravely and any individual or individuals employed by or representing Allegheny Pepsi-Cola Bottling Company; Mid-Atlantic Coca-Cola Bottling Company, Inc. or any other soft drink bottling company for the period January 1, 1984 to the date of this subpoena . . . ."

4. Sometime after September 12, 1984, the exact date being unknown to the Grand Jury, the defendant, knowing of the existence of the aforesaid grand jury investigation, willfully, knowingly and corruptly endeavored to influence, obstruct or impede the due administration of justice in the United States District Court for the Eastern District of Virginia by causing the destruction or concealment of tape recordings described in paragraph 2 of this Count that were material to the grand jury's investigation.

5. The defendant had reason to believe and did believe that the grand jury would order the production of these tape recordings, and so believing, he caused their destruction or concealment for the purpose and with the effect of preventing the disclosure of the tape recordings to the grand jury, in violation of Title 18, United States Code, Section 1503.

COUNT FOUR

The Grand Jury further charges:

1. Each and every allegation contained in paragraph 1 of Count One and paragraph 2 of Count Two of this Indictment is here realleged with the same force and effect as though said paragraphs were set forth in full detail.

2. During 1985, James C. Jones was Marketing and Merchandising Manager of Allegheny Pepsi in Richmond, Virginia.

3. In or about the spring or summer of 1985, the defendant unlawfully, willfully, knowingly and corruptly did endeavor to influence, obstruct or impede the due administration of justice in the United States District Court for the Eastern District of Virginia, in that the defendant, knowing that James C. Jones would likely be a witness before a duly impanelled grand jury in the Eastern District of Virginia, urged, advised and attempted to persuade James C. Jones to testify falsely, in violation of Title 18, United States Code, Section 1503.

A TRUE BILL

Dated:

Foreperson

Douglas Ginsburg

DOUGLAS H. GINSBURG
Assistant Attorney General

DAVID C. JORDAN

Joseph H. Widmar

JOSEPH H. WIDMAR

WILLIAM H. GITLOW

ANTHONY V. NANNI

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HENRY E. HUDSON
United States Attorney
Eastern District of Virginia

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF VIRGINIA
ROANOKE DIVISION

UNITED STATES OF AMERICA)
v.) Criminal No. 87-00061
RAYMOND H. RISSMILLER,) Filed: 6/22/87
Defendant.) 15 U.S.C. § 1

Judge James Turk

CRIMINAL INFORMATION

The United States of America, acting through its attorneys, charges:

I.

DEFENDANT

1. Raymond H. Rissmiller is made a defendant herein. During the period of time covered by this Information, the defendant was a Vice President of Wometco Coca-Cola Bottling Company of Roanoke, Inc. ("Wometco Coca-Cola") and later, a Director of Sales for Coca-Cola Bottling Company of Roanoke, Inc., a subsidiary of Coca-Cola Bottling Co. Consolidated of Charlotte, North Carolina ("Consolidated Coca-Cola"), when Consolidated Coca-Cola purchased Wometco Coca-Cola in February 1985. During the period of time covered by this Information, Wometco Coca-Cola and Consolidated Coca-Cola were engaged in the soft drink beverage business in the Western District of Virginia.

2. Whenever in this Information reference is made to any act, deed or transaction of a corporation, such allegation shall be deemed to mean that said corporation engaged in such act, deed or transaction by or through its officers, directors, agents, employees or representatives while they were actively engaged in the management, direction, control or transaction of its business or affairs.

II.

CO-CONSPIRATORS

3. Various corporations and individuals, not named as defendants in this Information, participated as co-conspirators in the offense charged herein, and performed acts and made statements in furtherance thereof.

III.

TRADE AND COMMERCE

4. The manufacture, distribution and sale of soft drinks (meaning a nonalcoholic, flavored and carbonated beverage) involve several levels of commercial activity:

(a) national manufacturers produce soft drink concentrate or syrup which they sell to local soft drink bottling companies;

(b) soft drink bottling companies mix the concentrate or syrup with carbonated water and other ingredients to make soft drinks which are then packaged in cans, bottles and other dispensing containers;

(c) soft drink bottling companies, such as Wometco Coca-Cola and Consolidated Coca-Cola, distribute and sell soft drinks to retail food, convenience, drug, liquor and mass merchandise stores; hotels, motels, schools and other institutions; and companies that lease or own vending machines; and

(d) consumers purchase soft drinks from the customers of Consolidated Coca-Cola and other soft drink bottling companies.

5. During the period of time covered by this Information, Consolidated Coca-Cola, Wometco Coca-Cola and other soft drink bottling companies frequently issued and distributed what are called "promotional letters" that describe prices and discounts offered for certain time periods to customers for various soft drink packages.

6. During the period of time covered by this Information, Consolidated Coca-Cola, Wometco Coca-Cola and other co-conspirator bottling companies conducted business in the Western District of Virginia.

7. During the period of time covered by this Information, substantial quantities of soft drink concentrate and syrup used to make soft drinks, as well as soft drink cans, bottles and other packaging materials, were shipped from outside the Commonwealth of Virginia, in a continuous and uninterrupted

flow of interstate commerce, to Wometco Coca-Cola and Consolidated Coca-Cola production facilities in Virginia, for use in the bottling and sale of soft drinks in the Western District of Virginia.

8. During the period of time covered by this Information, the activities of the defendant and co-conspirators, as charged herein, were within the flow of, and substantially affected, interstate commerce.

IV.

OFFENSE CHARGED

9. Beginning at least as early as 1982 and continuing thereafter at least through November 1985, the exact dates being unknown to the United States, the defendant and co-conspirators engaged in a combination and conspiracy in unreasonable restraint of the aforementioned interstate trade and commerce, in violation of Section 1 of the Sherman Act, 15 United States Code § 1.

10. The aforesaid combination and conspiracy consisted of a continuing agreement, understanding and concert of action among the defendant and co-conspirators, the substantial term of which was to fix the prices of cola and other soft drink products in the Western District of Virginia.

11. For the purpose of forming and effectuating the aforesaid combination and conspiracy, the defendant and co-conspirators did those things that they combined and conspired to do, including, among other things:

(a) participating in meetings and discussions to adhere to promotional letter prices and to increase the wholesale prices of 16-ounce nonreturnable bottles of cola and other soft drink products;

(b) agreeing to adhere to promotional letter prices and to increase the wholesale prices of 16-ounce nonreturnable bottles of cola and other soft drink products; and

(c) monitoring and enforcing the pricing agreements.

V.

EFFECTS

12. The combination and conspiracy charged herein had the following effects, among others:

(a) prices of certain soft drink products sold by Wometco Coca-Cola, Consolidated Coca-Cola and co-conspirator soft drink bottling companies in the Western District of Virginia were fixed and raised; and

(b) customers of the defendant and co-conspirator soft drink bottling companies in the Western District of Virginia were deprived of the opportunity to purchase certain cola and other soft drink products in an open and competitive market.

VI.

JURISDICTION AND VENUE

13. The aforesaid combination and conspiracy was carried out, in part, within the Western District of Virginia and within the five years preceding the filing of this Information.

Dated: June , 1987

CHARLES F. RULE
Acting Assistant Attorney General

Joseph H Widmar
JOSEPH H. WIDMAR

ANTHONY V. NANNI

ROBERT E. BLOCH

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IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
NORFOLK DIVISION

UNITED STATES OF AMERICA)
)
v.) Criminal No. 87-79-N
)
JAMES P. SHERIDAN,)
) Filed 6/19/87
Defendant.)
Judge Robert G. Doumar

INFORMATION

The United States of America, acting through its attorneys, charges:

I.

DEFENDANT

1. JAMES P. SHERIDAN is hereby made a defendant herein. During the period of time covered by this Information, James P. Sheridan was president and general manager of Allegheny Pepsi-Cola Bottling Company (hereinafter referred to as "Allegheny Pepsi"). During the period of time covered by this Information, James P. Sheridan, as president and general manager of Allegheny Pepsi, was engaged in the soft drink beverage business in the Eastern District of Virginia.

2. Whenever in this Information reference is made to any act, deed or transaction of any corporation, such allegation shall be deemed to mean that said corporation engaged in such act, deed or transaction by or through its officers, directors, agents, employees or representatives while they were actively engaged in the management, direction, control or transaction of its business or affairs.

II.

CO-CONSPIRATORS

3. Various firms and individuals, not made defendants herein, participated as co-conspirators in the offense charged herein and performed acts and made statements in furtherance hereof.

III.

TRADE AND COMMERCE

4. The manufacture, distribution and sale of soft drinks (meaning a nonalcoholic, flavored and carbonated beverage) involve several levels of commercial activity:

(a) national manufacturers produce soft drink concentrate or syrup which they sell to local soft drink bottling companies;

(b) soft drink bottling companies mix the concentrate or syrup with carbonated water and other ingredients to make soft drinks which are then packaged in cans, bottles and other dispensing containers;

(c) the soft drink bottling companies, such as Allegheny Pepsi, distribute and sell soft drinks to retail food, convenience, drug, liquor and mass merchandise stores; hotels, motels, schools and other institutions; and companies that lease or own vending machines; and

(d) consumers purchase soft drinks from the customers of Allegheny Pepsi and other soft drink bottling companies.

5. Allegheny Pepsi and other soft drink bottling companies frequently issue and distribute what are called "promotional letters" that describe discounts and prices offered for limited time periods to customers for certain soft drink packages.

6. During the period of time covered by this Information, Allegheny Pepsi and a co-conspirator soft drink bottling company conducted business in the Eastern District of Virginia through divisions headquartered in Norfolk and Richmond, Virginia.

7. During the period of time covered by this Information, substantial quantities of soft drink concentrate and syrup used to make soft drinks, as well as soft drink cans, bottles and other packaging materials, were shipped from outside the Commonwealth of Virginia, in a continuous and uninterrupted

flow of interstate commerce, to the production facilities of Allegheny Pepsi and a co-conspirator soft drink bottling company in Virginia for use in the bottling and sale of soft drinks in the Norfolk and Richmond areas of Virginia.

8. During the period of time covered by this Information, a co-conspirator soft drink bottling company produced and shipped substantial quantities of soft drinks from outside the Commonwealth of Virginia in a continuous and uninterrupted flow of interstate commerce to facilities of that company in Virginia for sale in the Norfolk and Richmond areas of Virginia.

9. During the period of time covered by this Information, Allegheny Pepsi and a co-conspirator soft drink bottling company produced and shipped substantial quantities of soft drinks from their production facilities in Maryland and Virginia to their distribution facilities in other states for sale in those destination states in a continuous and uninterrupted flow of interstate commerce.

10. During the period of time covered by this Information, the activities of the defendant and co-conspirators, as charged herein, were within the flow of, and substantially affected, interstate commerce.

IV.

OFFENSE CHARGED

11. Beginning in or about February 1983 and continuing thereafter into at least the last quarter of 1984, the exact dates being unknown to the United States, the defendant and co-conspirators engaged in a combination and conspiracy in unreasonable restraint of the above-described interstate trade and commerce, in violation of Section 1 of the Sherman Act, 15 United States Code § 1.

12. The aforesaid combination and conspiracy consisted of a continuing agreement, understanding and concert of action among the defendant and co-conspirators, a substantial term of which was to fix the prices of soft drinks sold by Allegheny Pepsi and a co-conspirator soft drink bottling company in the areas of Virginia served by the Norfolk and Richmond divisions of both companies.

13. For the purpose of forming and effectuating the aforesaid combination and conspiracy, the defendant and co-conspirators did those things that they combined and conspired to do, including, among other things:

(a) participating in meetings and telephone conversations to reduce discounts and to discuss and agree upon promotional letter prices of soft drinks;

(b) agreeing to set certain minimum soft drink promotional letter prices and to increase promotional letter prices of certain soft drinks for Allegheny Pepsi and a co-conspirator soft drink bottling company in the Norfolk and Richmond areas of Virginia;

(c) instructing subordinate employees of Allegheny Pepsi to meet with representatives of a co-conspirator soft drink bottling company to fix prices;

(d) approving the issuance of promotional letters reflecting pricing agreements between Allegheny Pepsi and a co-conspirator soft drink bottling company;

(e) agreeing to adhere to promotional letter prices; and

(f) making efforts to enforce pricing agreements between Allegheny Pepsi and a co-conspirator soft drink bottling company.

V.

EFFECTS

14. The combination and conspiracy charged herein had the following effects, among others:

(a) prices of certain soft drink products sold by Allegheny Pepsi and a co-conspirator soft drink bottling company in the Norfolk and Richmond areas were fixed and raised; and

(b) customers of the defendant and co-conspirators in the Norfolk and Richmond areas were deprived of the opportunity to purchase certain soft drink products in an open and competitive market.

VI.

JURISDICTION AND VENUE

15. The aforesaid combination and conspiracy was carried out, in part, within the Eastern District of Virginia and within the five years preceding the filing of this Information.

Dated:

CHARLES F. RULE
Acting Assistant Attorney General

Joseph H. Wi
JOSEPH H. WIDMAR

ANTHONY V. NANNI

ROBERT E. BLOCH

Attorneys, Antitrust Division
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UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
NORFOLK DIVISION

UNITED STATES OF AMERICA)
v.)
EDWARD LEON WYNNS,)
Defendant.)

Criminal No. 87-68-N
Filed: MAY - 7 1987
Violations:
18 U.S.C. § 1623
(False Declarations to Grand Jury)
18 U.S.C. § 1503
(Obstruction of Justice)

MAY 1987 TERM - AT NORFOLK, VIRGINIA

INDICTMENT

The Grand Jury charges:

COUNT ONE
(18 U.S.C. § 1623)

1. Edward Leon Wynns is indicted and made a defendant herein. At the time he made the declarations charged in this indictment, Edward Leon Wynns was Senior Vice President of Sales for Mid-Atlantic Coca-Cola Bottling Company, Inc. (herein referred to as "Mid-Atlantic Coke"). At all times relevant to this indictment, Edward Leon Wynns was engaged in the soft drink beverage business as Vice President and Division Manager for the Washington Division, Vice President of Sales and Marketing, Vice President of Sales or Senior Vice President of Sales for Mid-Atlantic Coke.

2. Mid-Atlantic Coke is headquartered in Silver Spring, Maryland, and manufactures, distributes and sells soft drinks in cans, bottles and other dispensing containers to retail food, convenience, drug, liquor and mass merchandise stores; hotels, motels, schools and other institutions; and companies that lease or own vending machines. Mid-Atlantic Coke is engaged in the soft drink beverage business in, among other areas, the Eastern District of Virginia through its Washington Division office which is also located in Silver Spring, Maryland.

3. On May 14, 1986, in the Eastern District of Virginia, Edward Leon Wynns testified under oath as a witness before a federal grand jury duly empaneled by the United States District Court for the Eastern District of Virginia, sitting in Norfolk,

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

Q: Have you ever met with and had discussions with Norman Hayter?

A: Sure.

Q: About what?

A: About things that we had to do with legislation on deposit, the anti-litter law deal they were trying to pass, the bottle deposit legislation they were trying to pass in the District, stuff like that.

Q: Have you ever had any discussions with him about promotional letters?

A: No, sir. Let me say this. I've never met with the man alone to discuss the stuff about the anti-litter law, and that stuff. I've never met with him alone.

Q: All your meetings with Norman Hayter have been in the presence of other people?

A: Yeah, group deal, you know, other bottlers.

Q: Have you had telephone conversations with Norman Hayter?

A: I've had one, two, maybe. One was one time he told me about a meeting he had planned. Another was the time I told you he made a call, wanted to verify a price to a third party operator.

Q: Are those the only occasions on which you have talked to him on the phone?

A: Only ones I can recall ever talking to him on the phone.

7. The aforesaid declarations of Edward Leon Wynns, as he then and there knew, were false in that: (a) he was aware of, participated in and did recall one or more contacts, communications, meetings and telephone conversations with one or more representatives of a wholly owned subsidiary of General Cinema Corp. (GCC), General Cinema Beverages of Washington, D.C., Inc., a soft drink beverage competitor also doing business in the Eastern District of Virginia, in which prices, discounts, marketing agreements, marketing programs, adherence to prices published in promotional letters or other matters relating to prices were discussed; and (b) he set up and participated in one or more meetings involving only representatives of General Cinema Beverages of Washington, D.C., Inc., including meeting alone with Norman Hayter.

8. The aforesaid declarations of Edward Leon Wynns were made in the Eastern District of Virginia within the period of

any applicable statute of limitations, in violation of Title IV of the Organized Crime Control Act of 1970, 18 U.S.C. § 1623.

COUNT TWO
(18 U.S.C. § 1623)

The Grand Jury further charges:

9. Each and every allegation contained in paragraphs 1 through 5 of Count One of this indictment is here realleged with the same force and effect as though each such paragraph was set forth in full detail.

10. At the aforesaid time and place, Edward Leon Wynns, while under oath, knowingly declared falsely before said federal grand jury with respect to a material matter set out in paragraph 5 of Count One of this indictment as follows:

[Declarations charged as false are underscored.]

Q. Have you ever received a promotional letter or a price letter from a competitor?

A. I have not.

Q. Do you have any reason to suspect or know that any individual at Mid-Atlantic Coke has ever received a price letter or promotional letter from a competitor?

A. No, I do not.

Q. You have no reason to suspect that any of the people that worked for you in the Washington Division ever received such letters from competitors?

A. No.

Q. Do you have any reason to believe or suspect that anyone at Mid-Atlantic Coke has ever transmitted a promotional letter or price letter to a competitor?

A. No, I have no knowledge of it, no.

Q. Do you have any reason to suspect that that has occurred?

A. No, I don't. They're too easily acquired from the customer, legally. The customer is going to call you, "Are you going to meet this price?" They produce the letter, and you're sitting there looking at it, the guy brings it in, "Can I meet this price?"

Q. Do you have any reason to suspect that anyone at Mid-Atlantic Coke has transmitted a promotional letter to a competitor prior to the date on which that letter was distributed to the trade?

A. No, I have no knowledge of or -- I have no knowledge of anyone doing that, no.

* * * *

Q. Have you ever received or transmitted to a competitor written communication concerning prices or discounts?

A. No.

* * * *

Q. Do you have any knowledge or reason to suspect that any competitor has ever given anyone at Mid-Atlantic Coke copies of lists of prices or promotional letters?

A. No. I have no knowledge.

11. The aforesaid declarations of Edward Leon Wynns, as he then and there knew, were false in that he was aware of and participated in one or more transfers of written information about prices or about matters affecting prices between one or more representatives of Mid-Atlantic Coke and General Cinema Beverages of Washington, D.C., Inc.

12. The aforesaid declarations of Edward Leon Wynns were made in the Eastern District of Virginia within the period of any applicable statute of limitations, in violation of Title IV of the Organized Crime Control Act of 1970, 18 U.S.C. § 1623.

COUNT THREE
(18 U.S.C. § 1623)

The Grand Jury further charges:

13. Each and every allegation contained in paragraphs 1 through 5 of Count One of this indictment is here realleged with the same force and effect as though each such paragraph was set forth in full detail.

14. At the aforesaid time and place, Edward Leon Wynns, while under oath, knowingly declared falsely before said federal grand jury with respect to a material matter as set out in paragraph 5 of Count One of this indictment as follows:

[Declarations charged as false are underscored.]

Q. Have you ever entered into an agreement with a competitor about prices?

A. No.

Q. Do you know of anyone at Mid-Atlantic Coke who ever has entered into an agreement with a competitor concerning prices?

A. No.

Q. Do you have any reason to suspect that anyone at Mid-Atlantic Coke has entered into an agreement with a competitor concerning prices or other competitive matters?

A. No.

15. The aforesaid declarations of Edward Leon Wynns, as he then and there knew, were false in that he was aware of and participated in one or more agreements about prices, including agreements about third-party commissions, wholesale prices and adherence to promotional letter prices, involving Mid-Atlantic Coke and General Cinema Beverages of Washington, D.C., Inc.

16. The aforesaid declarations of Edward Leon Wynns were made in the Eastern District of Virginia within the period of any applicable statute of limitations, in violation of Title IV of the Organized Crime Control Act of 1970, 18 U.S.C. § 1623.

COUNT FOUR
(18 U.S.C. § 1503)

The Grand Jury further charges:

17. Each and every allegation contained in paragraphs 1 and 2 of Count One of this indictment is here realleged with the same force and effect as though each such paragraph was set forth in full detail.

18. During May 1986, a grand jury empaneled by the United States District Court for the Eastern District of Virginia, sitting in Norfolk, Virginia, was conducting an investigation to determine, among other things, whether any person or company engaged in the soft drink beverage business had committed any violations of the Sherman Act, 15 U.S.C. § 1, *et seq.*, or other federal criminal laws in the Eastern District of Virginia and other areas including, but not limited to, the District of Columbia and parts of Maryland.

19. On May 14, 1986, Edward Leon Wynns, pursuant to a grand jury subpoena *ad testificandum*, appeared and gave testimony before the grand jury. During his appearance, Edward Leon Wynns, knowing of the existence of the aforesaid grand jury investigation, willfully, knowingly, and corruptly did influence, obstruct and impede and endeavor to influence, obstruct and impede the due administration of justice by the aforesaid grand jury by knowingly testifying falsely and evasively that he had not participated in, or that he had no knowledge of or information concerning, price fixing or other

collusive conduct involving representatives of companies engaged in the soft drink beverage business in the Eastern District of Virginia including, but not limited to, communications, transfers of written information or agreements about prices or about matters affecting prices as well as meetings between or among competitors.

20. The aforesaid corrupt endeavor to influence, obstruct and impede the due administration of justice was carried out by Edward Leon Wynns within the Eastern District of Virginia within the period of any applicable statute of limitations, in violation of 18 U.S.C. § 1503.

DATED:

A TRUE BILL

FOREPERSON

CHARLES F. RULE
ACTING ASSISTANT ATTORNEY
GENERAL

Joseph H. Widmar
JOSEPH H. WIDMAR

Anthony V. Nanni
ANTHONY V. NANNI

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Senator **Metzenbaum**. Our next witnesses are Robert Abrams, Attorney General of New York, and I think the President of the National Association of Attorneys General. Is that correct, Mr. Abrams?

Mr. **Abrams**. President-elect.

Senator **Metzenbaum**. President-elect, okay.

Rodney Leonard, Executive Director of the Community Nutrition Institute; and Ernest Gellhorn, Partner, Jones, Day, Reavis and Pogue, of Washington. We are happy to welcome all of you.

Just because I read them in that order but for no other reason—no, I think that I will not do that. I think I will have Mr. Abrams, then Mr. Gellhorn, and then Mr. Leonard. Mr. Abrams, will you please proceed with a 5-minute limit?

STATEMENT OF A PANEL CONSISTING OF ROBERT ABRAMS, ATTORNEY GENERAL, STATE OF NEW YORK, AND PRESIDENT-ELECT, NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, NEW YORK, NY; ERNEST GELLHORN, MANAGING PARTNER, JONES, DAY, REAVIS AND POGUE, WASHINGTON, DC; AND RODNEY E. LEONARD, EXECUTIVE DIRECTOR, COMMUNITY NUTRITION INSTITUTE, WASHINGTON, DC

Mr. **Abrams**. Thank you very much, Mr. Chairman. Seated to my left is Lloyd Constantine, the Assistant Attorney General in New York State who is in charge of the antitrust bureau in our office.

I am honored to present my views and those of the National Association of Attorneys General on S. 567, a bill that would grant an antitrust exemption for territorial monopolies in the distribution of beer in this country.

This piece of special interest legislation is intended to grant a single industry a license to eliminate competition. Because beer drinkers tend to be extremely loyal to particular brands, competition within the beer industry is primarily intrabrand; that is, competition among distributors of the same brand.

Competition among wholesalers or distributors selling the same brand acts as a lever against monopoly pricing. In fact, interbrand price competition in the beer industry is illusory when, as is often the case, the same wholesaler serves as an exclusive distributor for different brands in the same area.

I predicted large price increases when Busch and Miller adopted territorial distribution monopolies in 1983. In 1983, New York also adopted a bottle deposit law which was expected to raise the retail price of both beer and soft drinks in roughly equivalent amounts.

Price surveys conducted by the New York City Department of Consumer Affairs show that during the period from December of 1982 to June of 1987, beer prices surveyed rose approximately 39.5 percent, while soft drink prices actually declined.

I draw an unambiguous conclusion from these startling figures. The grossly disproportionate rise in beer prices is due in large part to the effects of the distribution monopolies. The sponsors' rationale for the bill is that it will foster competition when, in fact, it will do just the opposite.

The Supreme Court in *Continental TV, Inc.* v. *GTE Sylvania* ruled that exclusive distribution arrangements violate the antitrust laws if they have a predominantly anticompetitive effect.

Under the Sylvania standard, a vertical restraint that stifles interbrand competition without fostering competition among brands is illegal. Proponents of this bill have urged three justifications, arguing that it is necessary to solve the problem of stale beer, to eliminate transshipment of the product, and to avoid costly antitrust litigation.

The solution to the so-called stale beer problem lies in legible date labeling, an already common practice in the industry. The second justification concerns transshipment, said to be a ruinous form of competition that results in the business failures of wholesalers who are unable to compete against the transshipper who gets a so-called free ride from its competitors' advertising and promotional expenditures.

Transshipment is justifiably regarded by the antitrust laws as merely one form of lawful competition. It increases the number of sellers in the marketplace, and therefore leads to lower retail prices.

In New York State, which had an open beer market until Anheuser-Busch and Miller instituted national distribution monopolies in 1983, distributors lawfully transshipped their beer throughout the State.

The brewers imposed air-tight restrictions on the resale of beer by the distributors. In return, the distributors were granted monopolies in geographic markets, which in some cases encompassed millions of people.

The third argument concerns the high cost of defending antitrust litigation, which is part of the price of doing business in America. It is a risk that can only be eliminated by depriving consumers of the fundamental right to seek redress in the courts.

Busch and Miller, the giant brewers who sell well over half the beer in the country, in fact, invited litigation in 1983 by instituting territorial monopolies in the face of current antitrust standards.

The regrettable enactment of the Soft Drink Interbrand Competition Act in 1980 has emboldened the beer industry to seek the same type of special interest legislation. If S. 567 succeeds, the already lengthy queue of industries seeking antitrust immunity will only grow longer.

That is why the National Association of Attorneys General passed a resolution strongly opposing this bill, which is clearly inimical to the interests of the nation's beer consumers. It will ensure a more concentrated wholesaler market in an industry which has become highly concentrated at both the brewer and distributor level.

Rick Rule and his predecessors have consistently stated that the beer industry appears to be one in which the risk that widespread use of exclusive territories may produce anti-competitive effects is almost uniquely high.

Given this position and the fact that the four major brewers have already created exclusive territories, one would have expected a Federal enforcement action to ensue. Because none has, I have reluctantly commenced litigation in Federal court. I say reluctantly because this problem is truly national in scope and it strains the modest resources of our office.

S. 567 is an attempt to head off our litigation. The case against S. 567 could not be stated more succinctly than it was by a document submitted to the New York State Legislature when, in 1976, it was proposed that territorial monopolies for beer distribution be mandated by law.

Mr. Chairman, I know that it is in the prepared testimony that was cited to you. Interestingly enough, the most cogent arguments at that time were being offered by the very proponents of the bill now, the brewers of this country.

So it is my hope that this committee will see fit to do what has been done in the past to reject what I consider to be an anti-consumer bill which is against the public interest.

[Prepared statement follows:]

STATE OF NEW YORK DEPARTMENT OF LAW
OFFICE OF ATTORNEY GENERAL ROBERT ABRAMS

STATEMENT OF

ROBERT ABRAMS
ATTORNEY GENERAL
NEW YORK STATE

BEFORE THE
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS
OF THE COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
CONCERNING
S. 567
THE "MALT BEVERAGE INTERBRAND COMPETITION ACT"
ON
AUGUST 4, 1987

Mr. Chairman and members of the subcommittee. On behalf of the National Association of Attorneys General and Attorney General Robert Abrams, I am honored to have this opportunity to present our views on S. 567 ("The Malt Beverage Interbrand Competition Act"), a bill that would grant an antitrust exemption to arrangements which create territorial monopolies for the distribution of beer in this country.

We maintain the strong opposition to this bill expressed in Attorney General Abrams previous written submissions to the committee. Recent developments in the beer industry merely confirm our worst expectations of the pernicious effects which result from distribution monopolies. This bill would facilitate the formation of these monopolies and put them beyond the reach of current federal antitrust standards concerning non-price vertical restraints of trade, while increasing the probability of collusion in this highly concentrated industry.

S. 567 is a meritless piece of special interest legislation, designed solely to provide one industry with license to eliminate competition and thereby nullify the basic guidance mechanism of the American system of free enterprise. Exemptions from the antitrust laws should not be granted to any industry unless there has been a compelling demonstration that competition has failed to perform its traditional function of allocation.

In 1979, the _Report of the President's National Commission For the Review of Antitrust Laws and Procedures_ concluded that exemptions from the national policy of free market competition,

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

The National Institute of Economics and Law has testified before the House Judiciary Committee's Subcommittee On Monopolies and Commercial Law that "[t]here is no empirical evidence to indicate that a "free-rider" problem exists, i.e. the sale of beer by some distributors at the advertising expense of others." Neither is there any evidence in New York State of the business failure of any franchised beer distributor because of transshipment.

The third argument advanced in support of this bill is that it is necessary to protect the industry against protracted and costly litigation. The risk of litigation is part of the price of doing business in America. It is a risk that can only be eliminated by depriving someone, in this case competitors and consumers, of the fundamental right to seek redress in the courts. Anheuser-Busch and Miller Brewing, the giant brewers who control well over half the national beer sales, were secure enough to institute territorial monopolies in 1983 in the face of current law and the risk of antitrust litigation. They are in a far better financial position than their potential adversaries to conduct protracted litigation, which can only be successful if the distribution monopolies are conclusively shown to be an unreasonable restraint of trade.

Furthermore, this bill will not even prevent litigation. Under S. 567 exclusive territorial arrangements would be deemed lawful so long as the particular brand of beer was in "substantial and effective competition" with other brands of beer. Nowhere is this term defined in the bill and its meaning is ambiguous. This new standard's relationship to the traditional "rule of reason" standard, utilized by the courts to determine the lawfulness of exclusive territorial arrangements, is not expressed. Accordingly, rather than protect against litigation, this will assure more litigation and require the courts to define a new standard.

The regrettable enactment of the Soft Drink Interbrand Competition Act in 1980 has emboldened the beer industry to seek the same type of special interest legislation. If S. 567 succeeds, the already lengthy queue of industries seeking antitrust immunity will only grow longer. The antitrust laws have already been sapped of much vitality by restrictive decisions like the Illinois Brick case and an enforcement policy at the Federal level which vacillates between neglect and open hostility to the rule of established law. Further erosion through exemptions like that proposed in S. 567 will result in a patchwork of differing antitrust rules for each industry, further restricting effective antitrust enforcement. The business community will labor under a byzantine array of diverse and shifting standards. This is why the National Association of Attorneys General passed a resolution strongly opposing this bill, specifically, and others of its genre which would weaken antitrust standards for selected industries.*

---

* A copy of the resolution is annexed to this testimony.

This bill is also clearly inimical to the interests of the nation's beer consumers. It will ensure a more concentrated wholesaler market in an industry which has become highly concentrated at both the brewer and distributor level, and in which the trend toward greater concentration continues.

The Committee is familiar with the Vertical Restraints Guidelines issued by the United States Department of Justice on January 23, 1985. These guidelines were issued in the guise of an interpretation of current "rule of reason" standards applicable to non-price vertical restraints. In July of 1985 NAAG resolved that these Guidelines were an inaccurate statement of the law designed to further weaken the standards set forth by the Supreme Court in the GTE Sylvania case and convince the Courts to treat resale price maintenance agreements and certain *per se* unlawful horizontal restraints as if they were vertical practices and subject to "rule of reason" analysis. In December 1985 the Attorneys General unanimously issued NAAG's own vertical guidelines which properly follow the letter and spirit of the Sherman Act and its interpretation by the United States Supreme Court. Shortly thereafter the houses of Congress concurrently resolved that the Department of Justice Guidelines were an inaccurate statement of the law and should neither be binding nor persuasive. Antitrust practitioners recognize that there is virtually no vertical restraint which the Antitrust Division could ever challenge under the Guidelines, which in fact explicitly "encourage" the use of such restraints by businesses.*

I belabor the laxity of the Department's Guidelines to make a point about the beer industry and the very restraints that S. 567 would immunize from suit. The beer industry is perhaps the only industry where proper application of the D.O.J. Guidelines should lead to a challenge of exclusive distribution arrangements. William F. Baxter, former Assistant Attorney General in charge of the Antitrust Division testified before this Committee that ".. this industry appears to be one in which the risk that widespread use of exclusive territories may produce anticompetitive effects is almost uniquely high."** Mr. Baxter's two successors have continued to adhere to this position. Given the Department's further admission that "we understand that virtually all brewers use exclusive territorial arrangements", one would have expected a federal enforcement action to have ensued. Because none has, Attorney General Abrams has reluctantly commenced litigation in United States District Court for the Eastern District of New York to challenge the legality of these practices in New York State. I say "reluctantly" because this problem is truly national in scope and strains the modest resources of even the largest state antitrust enforcement offices. S. 567 has evolved into a clearly focused attack on our case. It is an attempt to prevent the judicial process from taking its course.

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* Vertical Restraints Guidelines, U.S. Department of Justice (January 23, 1985) page 1 ¶1.

** Testimony of William F. Baxter, Before Committee on The Judiciary, November 7, 1983, pages 6 and 7.

The "Interbrand Competition Act" ignores the true nature of competition within the beer industry. Beer prices are kept down by intrabrand competition, that is, competition between distributors of the same brand. The beer consuming public has significant brand loyalty created in large measure by the hundreds of millions of dollars expended to create distinct brand identifies. If a single wholesaler controls a particular brand, there is a strong incentive for it to charge whatever price the market will bear. Competition from other wholesalers or distributors selling the same brand acts as a lever against monopoly pricing. Moreover, even the minimal effects of interbrand competition are often rendered illusory because the same wholesaler serves as an exclusive distributor for different brands in the same area, and thus there is no motive for the distributor to compete for sales by lowering his price for any particular brand. The record of antitrust enforcement also demonstrates that in highly concentrated industries with a limited number of distributors, price collusion often occurs. All these factors caused Attorney General Abrams to predict large price increases when Anheuser-Busch and Miller adopted distribution monopolies in 1983. Although not all the data is conclusive, the price surveys in New York confirm major price increases attributable to the enforcement of territorial exclusivity.

In price surveys conducted by the New York City Department of Consumer Affairs, in the period from December 1982 to June, 1987* beer prices surveyed have risen approximately 39.5% while soft drink prices have actually declined.** In 1983 New York also adopted a soft drink and beer bottle deposit law which was expected to raise the retail prices of beer and soft drinks in roughly equivalent amounts. We draw a logical conclusion from these startling figures. The grossly disproportionate rise in beer prices is due in large part to the effects of the distribution monopolies instituted by Anheuser-Busch and Miller Brewing in 1983.

In summing up, I will quote from a document submitted to the New York State Legislature when in 1976 it was proposed that territorial monopolies for beer distribution be mandated by law. The case against S. 567 could not be stated more succinctly.

> "If enacted this bill would grant territorial monopolies for the sale of beer to present beer wholesalers" ... The bill would restrict competition between brands. Many of the specialty, imported and marginal brands would be forced out of the New York State market. Concentration of market power would follow and, with it, higher consumer prices and reduced consumer choice .... The real objective of this bill, and of franchise protection laws in general, is special interest favoritism, granting wholesalers a perpetual hold on the

---

* December 1982 is the last month prior to the institution of exclusive distribution monopolies by Anheuser-Busch. June 1987 is the most recent month for which survey results are currently available.

** We have annexed the certified price surveys of the New York City Department of Consumer Affairs.

> distribution of products and foreclosing by legislation any competition.... The absence of any competition would inevitably precipitate a price rise."

The memorandum I quote from was submitted by the Miller Brewing Company. A memorandum similar in content was also submitted by the United States Brewers Association on behalf of its members which included, Anheuser-Busch, Miller Brewing and the Joseph Schlitz Brewing Company. Copies of both memoranda are annexed to my written testimony for the subcommittees' information.

The public interest would be well served by another and final resounding defeat for this ill-conceived and selfishly motivated legislation.

XVI.

NATIONAL ASSOCIATION OF ATTORNEYS GENERAL
ANNUAL MEETING
July 15 - 18, 1982
Mackinac Island, Michigan

RESOLUTION

OPPOSING LEGISLATION THAT WEAKENS ANTITRUST STANDARDS FOR SPECIFIC INDUSTRIES

WHEREAS, further attempts are being made in the 97th Congress to obtain special exemptions from the antitrust laws, such as the Malt Beverage Interbrand Competition Act, which provides a special exemption to beer manufacturers to enforce territorial restrictions in their contacts with licensees; H.R. 6467, which would exempt professional team sports leagues from antitrust liability in relocation of league teams and revenue sharing agreements; and H.R. 6262, which would provide an immunity to companies involved in joint research; and

WHEREAS, present antitrust standards adequately protect the interests of such businesses; and

WHEREAS, this legislation weakens antitrust standards and invites other industries to seek similar exemptions from the antitrust laws;

NOW, THEREFORE, BE IT RESOLVED that the National Association of Attorneys General:

1. Reaffirms its strong opposition to legislation that weakens antitrust standards for specific industries; and
2. Authorizes the General Counsel to transmit these views to the Congress, the Administration, and other appropriate officials.

Attorneys General Linley E. Pearson of Indiana and Tyrone C. Fahner of Illinois dissent.

The City of New York
DEPARTMENT OF CONSUMER AFFAIRS
80 LAFAYETTE STREET, NEW YORK, NEW YORK 10013
Telephone: 566- 0889
Simon P. Gourdine, *Commissioner*

November 18, 1983

Mr. Richard Weinberg
Assistant Attorney General
Two World Trade Center
Room 4579
New York, New York 10047

Dear Mr. Richard:

Confirming our telephone conversation, enclosed are the certified average Market Basket soda and beer figures for the years 1982 and 1983. The Department surveys Coca Cola and Budweiser or Miller.

Sincerely,

Connie Quigley

Connie Quigley
Researcher

CQ:jt
Enclosure

APPENDIX A

SODA AND BEER PRICES

Market Basket Week	Dates	Soda 1983	1982	Beer 1983	1982
425	12/20 - 12/31	$2.12	$2.29	$2.81	$2.66
426	01/03 - 01/14	2.28	2.23	2.79	2.62
427	01/17 - 01/28	2.27	2.26	2.83	2.74
428	01/31 - 02/11	2.29	2.26	2.80	2.73
429	02/14 - 02/25	2.31	2.24	2.83	2.75
430	02/28 - 03/11	2.32	2.28	2.81	2.75
431	03/14 - 03/25	2.24	2.26	2.81	2.76
432	03/28 - 04/08	2.28	2.26	2.78	2.77
433	04/11 - 04/22	2.28	2.21	2.76	2.81
434	04/25 - 05/06	2.25	2.14	2.84	2.67
435	05/09 - 05/20	2.27	2.21	2.84	2.63
436	05/23 - 06/03	2.19	2.16	2.82	2.58
437	06/06 - 06/17	2.05	2.19	2.85	2.58
438	06/20 - 07/01	2.05	2.13	2.79	2.56
439	07/05 - 07/15	2.05	2.15	2.79	2.73
440	07/18 - 07/29	2.08	2.17	2.56	2.77
441	08/01 - 08/12	2.05	2.13	2.85	2.79
442	08/15 - 08/26	2.13	2.15	2.81	2.79
443	08/29 - 09/09	2.12	2.17	2.86	2.80
444	09/12 - 09/23	2.30	2.16	3.37	2.82
445	09/30 - 10/07	2.28	2.12	3.31	2.82
446	10/11 - 10/21	2.20	2.16	3.45	2.78
447	10/24 - 11/04	2.21	2.17	3.50	2.79

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The City of New York
DEPARTMENT OF CONSUMER AFFAIRS
80 LAFAYETTE STREET, NEW YORK, NEW YORK 10013
Telephone: 566- 0888

Angelo J. Aponte, Commissioner

MEMORANDUM

TO: Richard Weinberg

FROM: Barbara Hummel

DATE: May 8, 1985

SUBJECT: Beer and Soda Prices

Enclosed are the certified average market basket soda and beer prices for weeks 448 through 476. The Department records prices for Coca-cola and Budweiser or Miller.

Please call me if you have any questions regarding these figures.

New York City Department of Consumer Affairs Market Basket

Low and High Prices

1988 Prices

Market Basket Number	Dates	Low	High
448	11/07-11/18	[illegible]	[illegible]
449	11/21-12/02	[illegible]	[illegible]
450	12/05-12/16	[illegible]	[illegible]
451	12/19-12/30	[illegible]	[illegible]

1989 Prices

Market Basket Number	Dates	Low	High
452	01/02-01/13	[illegible]	[illegible]
453	01/16-01/27	[illegible]	[illegible]
454	01/30-02/10	[illegible]	[illegible]
455	02/14-02/24	[illegible]	[illegible]
456	02/27-03/10	[illegible]	[illegible]
457	03/13-03/23	[illegible]	[illegible]
458&459	[illegible]	[illegible]	[illegible]
460&461	[illegible]	[illegible]	[illegible]
462&463	[illegible]	[illegible]	[illegible]
464&465	[illegible]	[illegible]	[illegible]
466&467	[illegible]	[illegible]	[illegible]
468	[illegible]	[illegible]	[illegible]
469	[illegible]	[illegible]	[illegible]
470	[illegible]	[illegible]	[illegible]
471	[illegible]	[illegible]	[illegible]
472	[illegible]	[illegible]	[illegible]

[illegible]

[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

If enacted, this bill would grant territorial monopolies for the sale of beer to present beer wholesalers. Entry into the beer wholesale business would be restricted to those already in it. The bill permits a beer wholesaler [illegible]

The bill would [illegible] competition between brands. [illegible]

In effect, this bill and similar franchise protection [illegible]

Wholesalers of [illegible] competition or incentive might become complacent [illegible]

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Recent decisions in Nebraska and Missouri have invalidated franchise protection laws and regulations.

On July 18, 1974 in the consolidated cases of United States Brewers Association, Inc. v. Nebraska and Joseph E. Seagram & Sons, Inc., et al v. Nebraska, 220 N. W 2d 544, the Nebraska Supreme Court unanimously reversed a lower court decision and held that the Nebraska statute regulating franchises between manufacturers of alcoholic beverages and their distributors was invalid as an unconstitutional impairment of the rights of manufacturers to terminate distributorships, establish additional distributorships, and market their products. In the opinion, Justice Boslaugh stated, ". . . the act in question is an unreasonable invasion of the personal and property rights of the plaintiff and must be declared unconstitutional."

The Missouri Supreme Court reached a similar result on March 12, 1975 in Brown-Forman Distillers Corp., et al v. Stewart, 520 S. W. 2d 1. In that case, the court upheld a lower court case which invalidated on constitutional grounds portions of an administrative regulation which purported to regulate termination of liquor franchises. The lower court held that the regulations were so vague and ambiguous that they were constitutionally offensive.

The inherent right of persons to contract with others is a principle of Anglo-Saxon law. Contracts are voluntary relationships mutually undertaken and the state should not impair that relationship.

Economic paternalism is abhorrent to our concept of free enterprise. Brewers and wholesalers should be free to negotiate their own franchise agreements. Brewers should be accorded the same freedom in selecting wholesalers accorded manufacturers of other products. They should not be discriminated against.

The sale of beer is already highly regulated. If beer wholesalers fear coercion from brewers, present federal and state antitrust laws, as well as beverage control laws and regulations provide adequate protection. No wholesalers, to our knowledge, claim or have claimed that present laws are inadequate to protect them from coercion.

The bill purports to maintain the quality of beer. This is nonsense. The best way to maintain the quality of beer is to insure free competition. No brewer could remain in business very long if its beer was not of consistent high quality.

The bill should be defeated.

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United States Brewers Association, Inc.
EXECUTIVE PARK TOWER, STUYVESANT PLAZA, ALBANY, N.Y. 12203
(518) 439-4551

DANIEL J. ADAMS
VICE PRESIDENT - NORTH EASTERN REGION

MAY 3, 1976

MEMORANDUM IN OPPOSITION
on behalf of the
UNITED STATES BREWERS ASSOCIATION, INC.

S. 7524-A, Stafford   A. 11352-A, Griffin

AN ACT to amend the General Business Law
to add a new article regulating franchise contracts
for the sale of beer.

The United States Brewers Association, Inc., the nation's oldest incorporated trade association, representing New York State's newest corporate brewing citizens The Joseph Schlitz Brewing Company, and Miller Brewing Company, and other brewe selling over 90 percent of the nation's beer production, strongly opposes this bill.

This bill would restrict the beer wholesale business to approximately 160-180 N.Y.S. Class C licenses, while granting territorial monopolies to these businesses. The above presently wholesales approximately 84.5 percent of the State's beer business which is valued at about $633.15 million. They average 5.8 beer brands and 35.6 assorted packages of beer per business. Twelve N.Y.S. counties do not have a wholesale beer business in operation. 267 brands are authorized for sale in N.Y.S. This bill, while granting exclusive control of 267 beer brands to 160-180 businesses forecloses competition, and perpetuates the status quo.

There are approximately 448 other Class C licensed businesses who sell at retail, and approximately 43,861 on and off premise licensees who sell at retail. Licensed businesses could only buy beer from the proposed wholesale franchise distributor, or the primary distributor in a designated area. 160-180 "primary distributors" may become complacent in dealing with "out of the way" or "small purchase" retailers. The bill is not in the best interest either of the "large purchase" retailer who sells at minimum markup, for he becomes subject to purchasing from the monopolistic beer wholesaler.

In turn, the consumer market, under the absence of brand purchasing competition, inevitably rises.

Concentration of brands or reduced consumer choice follows. Wholesale beer distributors are overwhelmingly multi-brand distributors. It is a marketing impossibility for a multi-brand wholesaler to sell all authorized brands of beer to all licensees authorized to sell beer at retail who are located in the franchisee's

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sales territory. Many imported, speciality and/or marginal brands would be forced out of the New York State malt beverage market, adding to concentration of market and domination of the New York beer market by those brands the "franchisee" seeks to aggressively market. A 100% distribution rate for 267 brands by 180 wholesalers selling 44,309 licensed accounts is delusive.

The bill grants the right to the beer wholesaler to sell his business to anyone willing to pay the price sought by the "franchisee". A "franchisee" could sell to anyone lacking financial and industry knowledge, or business and management ability. Conversely, two new state brewing operations, investing approximately one-half of a billion dollars in New York State would have to accept as a wholesaler anyone, or be forced to buy the franchise for its "fair market value".

The bill requires that the brewer must provide the wholesaler with at least 90 days prior written notice of an intent to terminate. In this three month time, a disgruntled wholesaler could impair or destroy a brand's image, reputation, availability and future prospects.

The brewer members of the United States Brewers Association, Inc., want and seek stability in their distributor relationships. Individually, they provide their respective wholesalers equity or franchise agreements. Contracts are voluntary, mutually undertaken and for nearly two centuries, brewers and wholesalers have both profited. No justifiable cause can now be served by the State choosing sides and injecting itself into mutually agreed upon business transactions.

In summary, the bill states its intent is to assure a constant supply of fresh and wholesome beer to the consumer. The efficient, well managed beer wholesaler now performs in this manner.

Yet, this concern in the market place, is an internal brewer/beer wholesaler industry problem. It can be effectively dealt with, without passage of S. 7524-A, A. 11352-A.

The United States Brewers Association, Inc., offers its assistance to the New York State Beer Wholesale industry, and to those who govern the beer industry, toward responsible and equitable action to solve the problems relating to overage merchandise.

U. S. B. A. strongly urges the defeat of S 7524-A; A 11352-A, yet its introduction has served a useful purpose in that it has informed the legislature of brewer/wholesaler relationships and brought to light inter-industry concerns. In correcting these concerns, the industry can unite and work in harmony toward solutions.

N.Y.S. Beer Wholesalers and the N.Y.S. staff of the United States Brewers Association, Inc., have always worked together and in harmony. There exists a mutual trust and respect. The Regional Vice President, United States Brewers Association, Albany, places himself at the disposal of the wholesaler and brewer, and offers to act as an intermediary on behalf of those seeking assistance to affect improved and equitable relations.

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STATE OF NEW YORK
DEPARTMENT OF LAW
120 BROADWAY
NEW YORK, NY 10271

(212) 341-2275

ROBERT ABRAMS
Attorney General

LLOYD CONSTANTINE
Assistant Attorney General in Charge
Antitrust Bureau

August 12, 1987

Honorable Howard Metzenbaum
United States Senate
Washington, D.C. 20510-6275

Att: Priscilla Budieri, Esq.

Re: S. 567 - Hearing of August 4, 1987

Dear Senator Metzenbaum:

On behalf of Attorney General Robert Abrams and myself, who both testified at the above hearing, I request that this correspondence be made part of the record thereof, in as much as the Chairman granted Senator De Concini's request to keep the record open for "several days" and Senator De Concini thereafter granted the request of witness Ernest Gellhorn to submit additional material for the record.

We wish to supplement the record with regard to four issues: First, the case of Commonwealth of Pepsico, Inc., 658 F.Supp. 816 (M.D. Pa. 1987), appeal docketed, No. 87-5351 (3d Cir. June 3, 1987), much discussed at the hearing; second, Senator De Concini's assertion that S. 567 is not an exemption from the law but rather a clarification of the existing law; third, the relevance of retail price surveys to the issue of the effect that territorial restraints have on wholesale prices; fourth, Ernest Gillhorn's assertion that the 1976 "Miller Memorandum" opposing territorial exclusivity on competitive grounds can be explained in terms of the standard of analysis applicable to non-price vertical restraints in 1976.

The Pepsico Case

In Pepsico the district court with no evidence before it dismissed the allegations of the Pennsylvania Attorney General that certain Pepsi bottlers were engaging in a horizontal group boycott of soft-drink resellers designed to enforce territorial exclusivity for the bottlers. However, the Soft Drink Interbrand Competition Act, 15 U.S.C. §§3501-03, and S. 567 would immunize the enforcement of territorial exclusivity by a manufacturer (brewer or bottler) by contract on a vertical basis, i.e. between manufacturer and distributor. It does not immunize the enforcement of exclusivity by horizontal conspiracy which remains a *per se* violation of the law. See United States v. General Motors, 384 U.S. 127 (1966).

The district court's clear error which will undoubtedly be reversed on appeal, is understandable because the confusing language and vague standard of the Soft-Drink Act has engendered

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other such mistakes and subsequent reversals. For example in State of Texas v. Coca Cola Bottling Co. of the Southwest, 697 S.W.2nd 677 (Tex. App. 4th Dist. 1985), a Texas appeals court reversed the lower court's ruling that the Soft-Drink Act pre-empted the application of Texas' anti-merger, an analogue to Clayton Act Section 7.

Rather than prevent litigation, statutes such as these engender much wasteful appellate litigation. We submit copies of the decision in Coca Cola and the amended complaint in Pepsico for inclusion in the record in as much as Senator De Concini permitted the district court opinion in Pepsico to be inserted therein.

S. 567 Does Not Clarify GTE Sylvania. It Overrules That Supreme Court Precedent

In Sylvania, the Supreme Court held that the rule of reason first to be applied to determining the legality of non-price vertical restraints of trade required a balancing of anticompetitive intrabrand effects with procompetitive effects, if any, in the interbrand market. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). S. 567 overrules that holding, by eliminating anticompetitive intrabrand effects from the equation.

S. 567 may well go beyond immunizing conduct which completely destroys intrabrand competition and immunize conduct which reduces interbrand competition as well. Whether this occurs depends upon the ultimate judicial construction of S. 567 which immunizes intrabrand restraints so long as such malt beverage products are "in substantial and effective competition with other malt beverage products within that defined geographical area." The problem is with the unknown meaning of "substantial and effective competition," as Assistant Attorney General Rick Rule noted in his testimony. Consider the establishment of exclusive distribution territories which clearly eliminates intrabrand competition and also decreases interbrand competition by increasing concentration and facilitating interbrand collusion. Presumably some interbrand competition continues and if such competition is deemed "substantial and effective", the restraint is immunized although it eliminates intrabrand competition and reduces interbrand competition.

The Relevance of Retail Price Surveys As A Measure of Wholesale Prices

As in our previous testimony before the Senate and House Judiciary Committees, we have submitted for the record beer and soft-drink price surveys conducted by the New York City Department of Consumer Affairs twice monthly. These surveys have been conducted for decades and were not done at our request. They show that measuring prices in the period December 1982 (the month prior to the installation of exclusive distribution territories by Anheuser-Busch in New York) to June 1987 (all four major brewers had instituted exclusive territories by 1984) beer prices had risen 39.5% while soft-drink prices had declined slightly. The surveys show this trend to be steady. Our assertion that these retail prices reflect the effects of territorial exclusivity is challenged in a wholesale price survey sponsored by the National Beer Wholesalers Association. Without addressing the issue of the objectivity of this beer wholesaler study, the question remains as to whether retail price surveys are relevant to the issue of wholesale price movements.

The obvious and direct connection between wholesale and retail price movements has been demonstrated many times and most recently and graphically in another regulated New York market.

In January 1987 the United States District Court for the Eastern District of New York in the case of *Farmland Dairies v. Commissioner of New York State Department of Agriculture and Markets*, 650 F.Supp. 939 (E.D.N.Y. 1987), ordered that a single new wholesaler be permitted to sell milk in four New York counties. The entrance of this single *wholesaler* resulted in an immediate retail price drop in the affected area variously surveyed as 22¢ to 50¢ per gallon of milk. Acting upon the basis of this dramatic effect New York in July enacted the Milk Control and Milk Producers Security Reform Act of 1987 which opened New York to new wholesaler competition for the first time in 53 years.

The proponents of S. 567 refuse to recognize an obvious and direct relationship between wholesale and retail prices which is both self-evident and documented.

The "Miller Memorandum" of 1976

In 1976 Miller Brewing and the United States Brewers Association whose members included Miller and Anheuser-Busch opposed exclusive distribution territories on competitive grounds in memoranda submitted to the New York State legislature. These memoranda, which are annexed to our testimony, make the point that exclusive distribution territories, which would be immunized by S. 567, destroy intrabrand competition, reduce interbrand competition, encourage collusion and inevitably raise prices. Parenthetically, in 1976 the brewers recognized the obvious and direct relationship between wholesale and retail prices which they now dispute (see discussion above).

At the hearing Ernest Gellhorn explained these 1976 memoranda in terms of the *per se* standard then applicable to certain non-price vertical restraints under the rule of *United States v. Arnold Schwinn & Co.*, 388 U.S. 365 (1967). This assertion is ludicrous. Similar laws in other states had already been upheld by the courts. *V.L. Cicione, Inc. v. C. Schmidt & Sons*, 403 F.Supp. 643 (E.D.Pa. 1975), *aff'd*, 565 F.2d 154 (Cir. 1977). The memoranda merely state the brewers' strongly felt belief that exclusive distribution territories are highly anticompetitive in both the intrabrand and interbrand markets. The issue of whether the courts were then applying a rule of reason or rule of *per se* illegality to these restraints was irrelevant to the brewers' factual assertion that these restraints actually destroyed competition. The brewers have now obviously caved in to the pressure exerted by beer wholesalers on a collective basis but this does not change the fact that the brewers opposed these restraints because of their obvious anticompetitive effects.

Very truly yours,

ROBERT ABRAMS

Lloyd Constantine /ahm.

By: LLOYD CONSTANTINE

RA:LC:ma

UNITED STATES DISTRICT COURT FOR THE
MIDDLE DISTRICT OF PENNSYLVANIA

COMMONWEALTH OF PENNSYLVANIA,
ex rel. LeRoy S. Zimmerman,
Attorney General of Pennsylvania,

Plaintiff,

v.

PEPSICO, INC.,
ALLEGHENY PEPSI-COLA BOTTLING CO., INC.,
and
CONFAIR BOTTLING CO., INC.,

Defendants.

Civil Action No. 86-1799

AMENDED COMPLAINT

The Commonwealth of Pennsylvania brings this action under the federal antitrust laws.

I. Jurisdiction and Venue

1. The Commonwealth of Pennsylvania brings this action under 28 U.S.C. § 1337 by its Attorney General, as *parens patriae*, to obtain a permanent injunction under section 16 of the Clayton Act, 15 U.S.C. § 26, preventing violations by defendants of section 1 of the Sherman Act, 15 U.S.C. § 1.

2. Each defendant is found, resides, or transacts business in the Middle District of Pennsylvania. Some or all of the claims stated arose in the Middle District of Pennsylvania. Venue as to each defendant is proper in the Middle District of Pennsylvania. 15 U.S.C. § 22 and 28 U.S.C. §§ 1391(b) and (c).

II. Plaintiff

3. Plaintiff is the Commonwealth of Pennsylvania. It brings this suit to protect the economy of Pennsylvania.

III. Defendants

4. PepsiCo, Inc. (PepsiCo), is incorporated under Delaware laws. PepsiCo has its world headquarters at Anderson Hill Road, Purchase, New York 10577. PepsiCo manufactures soft

drink syrup and concentrate and sells these products to soft drink bottlers throughout the United States.

5. Allegheny Pepsi Bottling Company, Inc. (Allegheny Pepsi), is a bottler of Pepsi-Cola products and is wholly owned by PepsiCo. It is incorporated under Delaware laws and has its principal place of business at 1650 Union Avenue, Baltimore, Maryland 21211. Allegheny Pepsi does business at 2501 Sycamore Street, Harrisburg, Pennsylvania 17111.

6. Confair Bottling Company, Inc. (Confair Bottling), is a bottler of Pepsi-Cola products. It is incorporated under Pennsylvania laws and has its principal place of business at 1450 Dewey Avenue, Williamsport, Pennsylvania 17701.

7. Allegheny Pepsi and Confair Bottling respectively have licensing agreements with PepsiCo and purchase Pepsi soft drink syrup and concentrate from PepsiCo. Allegheny Pepsi and Confair Bottling use these products to produce and package carbonated Pepsi-Cola soft drink, selling the final product to resellers in Pennsylvania. Each has an exclusive geographic bottling territory for Pepsi products granted to it by PepsiCo.

IV. Co-Conspirators

8. Various persons, firms, corporations, and other business entities, not named as defendants, have participated as co-conspirators with defendants in the alleged violations and performed acts and made statements in furtherance of these violations.

V. Trade and Commerce

9. PepsiCo has purchased and does purchase substantial quantities of raw materials in interstate commerce, and sells and ships substantial quantities of soft drink syrup and concentrate in interstate commerce.

10. Allegheny Pepsi and Confair Bottling have purchased and do purchase substantial quantities of soft drink ingredients outside Pennsylvania, and use these ingredients to produce and package carbonated soft drink at plants in Pennsylvania.

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11. Soft drink products manufactured and produced by defendants are sold in Pennsylvania to resellers.

12. Defendants' activities have been and are in the regular and continuous flow of interstate commerce and have a substantial effect upon interstate commerce.

VI. Allegations as to Conduct

13. Soft drink resellers include beer and soda distributors, restaurants, taverns, bars, vending companies, grocery stores, department stores and drug stores.

14. Allegheny Pepsi's and Confair Bottling's bottling territories adjoin or are close to one another.

15. Soft drink resellers are independently owned, and do not have licensing or franchise agreements with either PepsiCo or its bottlers.

16. Allegheny Pepsi and Confair Bottling at times charge different prices for the same soft drink.

17. Allegheny Pepsi and Confair Bottling also at times charge higher prices for the same soft drink to some resellers than to other resellers.

18. Resellers sometimes buy soft drink from other resellers, rather than from the bottler in whose territory the reseller is located.

19. Resellers buy from other resellers because their local bottler charges higher prices. Resellers also buy from each other when their local bottler either refuses to sell Pepsi products to them or refuses to sell Pepsi products to them in sufficient quantities.

20. At some time, now unknown, defendants, between and among themselves and their co-conspirators, agreed or otherwise combined to eliminate sales of soft drink between resellers.

21. To enforce their agreements and combinations to eliminate soft drink sales between resellers, defendants and their co-conspirators:

(a) instituted and use coding identification systems

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to trace, monitor and restrict the sales of soft drinks sold to resellers;

(b) police and enforce a fine system whereby bottlers are fined for product shipped or sold out of that bottler's territory by resellers;

(c) refuse to deal with resellers who buy or sell soft drink outside the bottling territory in which the reseller is located;

(d) refuse to deal with resellers who buy soft drink from, or sell soft drink to, other resellers located in the same bottling territory;

(e) combine with resellers not to sell soft drink to other resellers, and threaten to terminate them or limit their soft drink supplies if they do so; and

(f) limit sales to resellers to the amount of soft drink which defendants deem is needed for the reseller's retail sales to consumers within the bottling territory in which the reseller is located.

VII. Violation

22. Beginning at a date unknown to plaintiff and continuing to the present, defendants and their co-conspirators continuously engaged in unlawful contracts, combinations, or conspiracies, in unreasonable restraint of interstate trade and commerce, in violation of section 1 of the Sherman Act, 15 U.S.C. § 1. The unlawful contracts, combinations, or conspiracies will continue unless injunctive relief is granted.

23. Defendants' conduct consisted of, among other things, horizontal restraints of trade, group boycotts and agreements which, directly or indirectly, fixed or stabilized prices.

24. Defendants' conduct is not exempt from the antitrust laws under the defense provided by the Soft Drink Interbrand Competition Act of 1980, 15 U.S.C. §§ 3501 et seq.

VIII. Effects

25. The aforesaid unlawful contracts, combinations, or conspiracies have had the following effects, among others:

(a) horizontal competition in wholesale sales of soft drinks between and among resellers and bottlers has been restrained;

(b) soft drink resellers have been denied the ability to trade freely among themselves;

(c) prices of soft drink have been fixed or stabilized; and

(d) the Commonwealth and its citizens have been denied the benefits of free and open competition among soft drink resellers.

IX. Injury

26. As a result of the illegal contracts, combinations, or conspiracies, the Commonwealth of Pennsylvania has suffered irreparable injury to its property and to its general economy, and is threatened with further injury to its property and to its general economy unless defendants are enjoined from continuing or renewing their illegal conduct.

PRAYER FOR RELIEF

WHEREFORE, plaintiff requests:

a. That the contracts, combinations, or conspiracies among defendants and their co-conspirators be adjudged and decreed *per se* unreasonable restraints of trade in violation of section 1 of the Sherman Act, 15 U.S.C. § 1, and not exempt by reason of the defense of the Soft Drink Interbrand Competition Act of 1980, 15 U.S.C. §§ 3501 *et seq.*

b. That defendants, their respective directors, officers and other agents be permanently enjoined from continuing the above contracts, combinations, and conspiracies, and from adopting or following any practice or program having a similar purpose or effect.

c. That defendants, their respective directors, officers, and other agents be permanently enjoined from:

1. taking retaliatory actions against any past or present reseller of soft drink products;

11. refusing to sell any soft drink products to any past or present soft drink reseller with an acceptable credit rating who resells defendants' product only within the exclusive bottling territory in which the reseller is located; and

12. imposing and policing a system of fines or other system of restraints which operates, directly or indirectly, to enforce geographic bottling territories against resellers.

d. That defendants shall pay the cost of suit, including a reasonable attorney's fee.

e. That plaintiff be granted other such relief as this Court deems appropriate.

Dated: February 10, 1987

LEROY S. ZIMMERMAN
Attorney General

By: Eugene F. Waye
Eugene F. Waye
Deputy Attorney General
Chief, Antitrust Section

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Attorneys for the Commonwealth
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CERTIFICATE OF SERVICE

I hereby certify that on February 11, 1987, plaintiff's amended complaint was served on counsel for defendants by mailing a copy first-class United States mail, postage prepaid, to:

Fred J. [illegible], Esq.
Alan R. Boynton, Jr., Esq.
McNees, Wallace & Nurick
100 Pine St.
Harrisburg, PA 17108
Counsel for PepsiCo, Inc. and
Allegheny Pepsi-Cola Bottling Co., Inc.

and by sending a copy via Purolator to:

C. David [illegible], Esq.
McCormick, Reeder, Nichols, Sarno,
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Williamsport, PA 17701
Counsel for Coca-Cola Bottling Co., Inc.

Dated:

Kelly [illegible]
Deputy Attorney General
Antitrust Section

UNITED STATES DISTRICT COURT FOR THE
MIDDLE DISTRICT OF PENNSYLVANIA

COMMONWEALTH OF PENNSYLVANIA,
by Atty. LeRoy S. Zimmerman,
Attorney General of Pennsylvania,

Plaintiff,

v.

PEPSICO, INC.,
ALLEGHENY PEPSI-COLA BOTTLING CO., INC.,
and
GENERAL BOTTLING CO., INC.,

Defendants.

Civil Action No. 86-1799

ORDER

Pursuant to a conference call on February 3, 1987, with counsel for plaintiff and counsel for defendants PepsiCo, Inc. and Allegheny Pepsi-Cola Bottling Company, Inc., and upon the filing of an amended complaint by plaintiff, the motion of defendants PepsiCo, Inc. and Allegheny Pepsi-Cola Bottling Company, Inc. to dismiss the complaint is hereby denied.

Dated:

William W. Caldwell, U.S.D.J.

UNITED STATES DISTRICT COURT FOR THE
MIDDLE DISTRICT OF PENNSYLVANIA

COMMONWEALTH OF PENNSYLVANIA,
ex rel. LeRoy S. Zimmerman,
Attorney General of Pennsylvania,

Plaintiff,

v.

PEPSICO, INC.,
ALLEGHENY PEPSI-COLA BOTTLING CO., INC.,
and
COMPAIR BOTTLING CO., INC.,

Defendants.

Civil Action No. 86-1799

ORDER

Pursuant to a conference call with counsel for plaintiff and counsel for defendants PepsiCo, Inc. and Allegheny Pepsi-Cola Bottling Company, Inc. on February 3, 1987, the motion filed by PepsiCo, Inc. and Allegheny Pepsi-Cola Bottling Company, Inc. for a protective order and to stay discovery is hereby denied.

Dated:

William W. Caldwell, U.S.D.J.

The STATE of Texas, Appellant,

v.

COCA COLA BOTTLING COMPANY OF the SOUTHWEST and Dr. Pepper Company, Appellees.

No. 04-85-00032-CV.

Court of Appeals of Texas,
San Antonio.

Aug. 21, 1985.

Rehearing Denied Oct. 14, 1985.

State brought suit to divest bottling company of acquired assets. The 57th District Court, Bexar County, Fred Biery, J., sustained special exception on constitutional grounds and ordered cause of action dismissed, and State appealed. The Court of Appeals, Tijerina, J., held that section of Texas Free Enterprise and Antitrust Act was not unconstitutional under supremacy or commerce clauses.

Reversed and remanded.

Cadena, C.J., concurred in result and filed opinion in which Cantu, J., joined.

1. States ⇐4.13

Supremacy clause [U.S.C.A. Const. Art. 6, cl. 2] does not prevent State from adopting and enforcing antitrust statutes to secure competition and preclude combinations tending to defeat it. (Per Tijerina, J., with two Judges concurring in result.)

2. States ⇐4.9

State statute or regulation with only incidental effects on interstate commerce, regulated evenhandedly to effectuate legitimate local interest, would not be subject to preemption under supremacy clause. U.S. C.A. Const. Art. 6, cl. 2. (Per Tijerina, J., with two Judges concurring in result.)

3. Monopolies ⇐12(1.10)

Under rule of reason, fact finder weighs all of the circumstances of a case in deciding whether restrictive practice should be prohibited as imposing unreasonable restraint on competition. (Per Tijerina, J., with two Judges concurring in result.)

4. Monopolies ⇐12(1.10)

Under "rule of reason" used to analyze restrictions under Sherman Act [15 U.S. C.A. § 1 et seq.], relevant market must be defined by court in terms of both geography and product or services. (Per Tijerina, J., with two Judges concurring in result.) Sherman Anti-Trust Act, § 1 et seq., 15 U.S.C.A. § 1 et seq.

5. States ⇐4.13

Section of Texas Free Enterprise and Antitrust Act [V.T.C.A., Bus. & C. § 15.-

05(d)] providing that "It is unlawful for any person to acquire directly or indirectly, the whole or part of the stock or other share capital or the assets of any other person or persons, where the effect may be to lessen competition substantially in any line of trade or commerce" is not repugnant to Clayton Act [15 U.S.C.A. § 18] or Soft Drink Interbrand Competition Act [15 U.S. C.A. § 3501] and therefore is not preempted. (Per Tijerina, J., with two Judges concurring in result.) Clayton Act, § 7, 15 U.S.C.A. § 18; U.S.C.A. Const. Art. 6, cl. 2; Soft Drink, Interbrand Competition, § 2, 15 U.S.C.A. § 3501.

6. Commerce ⇐62.10

State is not generally prohibited from giving effect to its antitrust laws because regulation affects interstate commerce. (Per Tijerino, J., with two Judges concurring in result.)

7. Commerce ⇐62.11

Section of Texas Free Enterprise and Antitrust Act [V.T.C.A. Bus. § C. § 15.05(d)] providing that "It is unlawful for any person to acquire directly or indirectly, the whole or part of the stock or other share capital or the assets of any other person or persons, where the effect may be to lessen competition substantially in any line of trade or commerce" did not violate commerce clause [U.S.C.A. Const. Art. 1, § 8, cl. 3], since Texas statute had rational relationship to legitimate state interest, i.e., maintenance and promotion of economic competition in trade and commerce occurring wholly or partly within state. (Per Tijerina, J., with two Judges concurring in result.)

Paul D. Rich, Steven Baron, Austin, for appellant.

Gregory S.C. Huffman, Louise Ellen Teitz, Marshall M. Searcy, Raymond E. LaDriere, II, Dallas, J. Burleson Smith, Keith E. Kaiser, Cox & Smith, San Antonio, for appellees.

Before CADENA, C.J., and CANTU and TIJERINA, JJ.

TIJERINA, Justice.

In this case, § 15.05(d) of the Texas Free Enterprise and Antitrust Act of 1983, TEX. BUS. & COM.CODE ANN. § 15.01 *et seq.* (Vernon Supp.1985), was declared unconstitutional. Appellant's petition sought to divest Coca Cola Bottling Company of the Southwest of assets acquired from Dr. Pepper Company and Dr. Pepper Bottling. The trial court sustained appellee's special exception on constitutional grounds and ordered the cause of action dismissed with prejudice. We reverse and remand.

The State's pleadings alleged that the purpose of the lawsuit was to maintain and promote economic competition in the soft drink industry in the San Antonio area. Specifically the petition asserted that appellees violated section 15.05(d) of the Texas Free Enterprise and Antitrust Act, *supra*, by executing the following acquisitions agreements: (1) "Asset Purchase Agreement," under which Coca Cola acquired vending machines, vehicles, real estate, and certain intangible assets from Dr. Pepper Bottling and Dr. Pepper Company; and (2) "Dr. Pepper Bottlers License Agreement," under which Coca Cola Bottling acquire a license to carbonate, bottle, sell, and distribute Dr. Pepper in an exclusive territory in the San Antonio area. It was further urged that these agreements constituted anticompetitive acquisitions that would lessen competition substantially in the soft drink industry in the San Antonio area.

Appellees filed special exceptions claiming that section 15.05(d) of the TEX.BUS & COM.CODE ANN., *supra*, on which the State based its cause of action, was unconstitutional under the U.S. CONST. art. VI, cl. 2, the supremacy clause, and under U.S. CONST. art. I, § 8, cl. 3, the commerce clause. The trial court sustained these specific special exceptions filed by both appellees.

Our initial task is to determine whether federal antitrust legislation preempts § 15.05(d) of Texas Free Enterprise and Antitrust Act. The state argues that the challenged provisions of Texas Free Enterprise

Act and the provisions of the Clayton Act, 15 U.S.C.A. § 18 (West 1973 and Supp. 1985), are similar, harmonious, not competitive, and therefore valid. Appellees contend that the merger and acquisition restrictions prescribed by the state statute are in direct conflict with the Clayton Act and the Soft Drink Interbrand Competition Act (Soft Drink Act), 15 U.S.C. §§ 3501–03. They specifically allege that § 15.05(d) of the Texas antitrust statute impermissibly regulates, and that it disrupts the congressional purpose in the federal regulation of the soft drink industry. Appellees further urge that the federal statute impliedly preempts state regulations governing mergers and acquisitions. Section 15.05(d) Texas Free Enterprise and Antitrust Act provides in relevant part:

> It is unlawful for any person to acquire directly or indirectly, the whole or part of the stock or other share capital or the assets of any other person or persons, where the effect may be to lessen competition substantially in any line of trade or commerce.

The supremacy clause of the United States Constitution provides:

> This Constitution and the Laws of the United States which shall be made in Pursuance thereof ... shall be the supreme Law of the Land ..., any thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U.S. CONST. art. VI, cl. 2. The Supreme Court has promulgated the test for the determination of preemption issues as follows:

> The first inquiry is whether Congress, pursuant to its power to regulate commerce, U.S. CONST. art. I, § 8, has prohibited state regulation of the particular aspects of commerce involved in this case.... [W]hen Congress has 'unmistakably ... ordained,' *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142, 83 S.Ct. 1210, 1217, 10 L.Ed.2d 248 (1963), that its enactments alone are to regulate a part of commerce, state laws regulating that aspect of commerce must fall. This result is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose.

Jones v. Rath Packing Co., 430 U.S. 519, 525, 97 S.Ct. 1305, 1309, 51 L.Ed.2d 604, 613–14 (1977).

The relevant part of the Clayton Act provides:

> No person engaged in commerce or in any activity affecting commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no person subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another person engaged also in commerce or in any activity affecting commerce, where in any line of commerce or in any activity affecting commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

15 U.S.C.A. § 18 (West Supp.1985).

[1] "State antitrust statutes are not designed as a means for the regulation of the public market, nor as an attempt to control the price of goods offered for sale, but to suppress trusts, secure the benefits arising from competition in trade, prevent monopolies, and protect the people from the possible tyranny and oppression of combined wealth." *Monopolies, Etc.* 54 Am.Jur.2d § 452 (1971). "The purpose of [state antitrust] statutes is to secure competition and preclude combinations which tend to defeat it.... There is nothing in the Constitution of the United States which precludes a state from adopting and enforcing such policy." *International Harvester Co. v. Missouri*, 234 U.S. 199, 209, 34 S.Ct. 859, 862, 58 L.Ed. 1276 (1914).

[2] The United States Supreme Court in *Malone v. White Motor Corp.*, 435 U.S. 497, 98 S.Ct. 1185, 55 L.Ed.2d 443 (1978), considering a Minnesota statute being challenged under the supremacy clause, stated:

> Often Congress does not clearly state in its legislation whether it intends to

> preempt state laws; and in such instances, the courts normally sustain local regulation of the same subject matter unless it conflicts with federal law or would frustrate the federal scheme, or unless the courts discern from the totality of the circumstances that Congress sought to occupy the field to the exclusion of the States.

Id. at 504, 98 S.Ct. at 1190. However, the Supreme Court has been consistently concerned only with state statutes which substantially affect commerce, i.e., where the burden imposed on interstate commerce is excessive in relation to the local interests served. *See Edgar v. Mite Corp.*, 457 U.S. 624, 102 S.Ct. 2629, 73 L.Ed.2d 269 (1982). Thus, it appears that a state statute or regulation with only incidental effects on interstate commerce, regulated evenhandedly to effectuate a legitimate local interest, would not be subject to preemption under the supremacy clause. *See Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970); *Los Alamos School Board v. Wugalter*, 557 F.2d 709, 714 (10th Cir.), *cert. denied*, 434 U.S. 968, 98 S.Ct. 512, 54 L.Ed.2d 455 (1977).

The legislative history of the federal antitrust laws clearly indicates that Congress did not reserve the exclusive regulation of mergers and acquisitions to the exclusion of the States. The purpose of the Sherman Antitrust Act was to supplement the enforcement of established rules of the Common and Statute law of the several states dealing in antitrust matters. 21 Cong.Rec. 2, 456–57 (1890). The purpose of the Clayton Act was to supplement the Sherman Antitrust Act. *See* Report of the Senate Committee on the Judiciary; S.Rep. No. 698, 63d Cong., 2d Sess. 1 (1914). We do not conclude from the provisions of the federal antitrust laws that exclusive power, jurisdiction and authority to regulate mergers and acquisitions are vested in the Federal Trade Commission or the U.S. Attorney General.

In the instant case the State seeks to regulate the acquisition by the Coca Cola Bottling Company of the Southwest of the assets of Dr. Pepper Company and Dr. Pepper Bottling, in the San Antonio area only. It is evident that the Texas Free Enterprise Act was patterned on section 7 of the Clayton Act. There is similarity of purpose, identical language and the mandatory provision of section 15.04, *supra*, that the act be construed in harmony with federal judicial interpretations of comparable antitrust statutes.

The next question to be determined is whether section 15.05(d), *supra*, is impliedly preempted because of alleged conflicts with the Soft Drink Interbrand Competition Act. In 1980, Congress enacted the Soft Drink Interbrand Competition Act (Soft Drink Act), 15 USCA § 3501 (West 1982), "to clarify the circumstances under which territorial provisions in licenses to manufacture, distribute, and sell trademarked soft drink products are unlawful under the antitrust laws." 1980 U.S.CODE CONG. & AD.NEWS 2373. Congress passed this Act to abrogate a Federal Trade Commission ruling that territorial restrictions in the soft drink industry violated the federal antitrust laws; the Federal Trade Commission had applied an improper legal standard in evaluating the territorial exclusivity provisions.

[3] Section 3501 of the Soft Drink Act provides in relevant part:

> Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any trademark licensing contract or agreement, pursuant to which the licensee engaged in the manufacture (including manufacture by a sublicensee, agent or subcontractor), distribution, and sale of a trademark soft drink product, of provisions granting the licensee the sole and exclusive right to manufacture, distribute, and sell such product in a defined geographic area or limiting the licensee, directly or indirectly, to the manufacture, distribution, and sale of such product only for ultimate resale to consumers within a defined geographic area: *Provided, That such product is in substantial and effective com-*

> *petition with other products of the same general class in the relevant market or markets.* (Emphasis added.)

The Act further defines the term "antitrust law" to mean the Sherman Act (15 U.S.C. § 1, *et seq.*), the Clayton Act (15 U.S.C. § 12, *et seq.*), and the Federal Trade Commission Act (15 U.S.C. § 41, *et seq.*) It is apparent that Congress closely adhered to the "rule of reason" used by the Supreme Court as the appropriate antitrust analysis of restrictions under the Sherman Act. "Under this rule, the factfinder weighs all of the circumstances of a case in deciding whether a restrictive practice should be prohibited as imposing an unreasonable restraint on competition." *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 97 S.Ct. 2549, 53 L.Ed.2d 568 (1977).

[4, 5] A recent article defining the criteria for the standard of reasonableness stated: "A determination of reasonableness generally entails a comparative analysis of the effect of any resulting restraint in the relevant market." Selinger, *Sherman Marches on Austin: Some Comments About the New Texas Antitrust Act*, 47 TEX.B.J. 56 (1984). The relevant market must be defined by the court in terms of both geography and product or services. Absent such a delineation, there is no point of reference for measuring a company's ability to lessen competition, control prices, or exclude competitors. *U.S. v. Grinnell, Corp.*, 384 U.S. 563, 86 S.Ct. 1698, 16 L.Ed.2d 778 (1966); *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172, 86 S.Ct. 347, 15 L.Ed.2d 247 (1965). Thus, it appears that under the compelling standards mandated by the Soft Drink Act, the critical question is whether the product is "in substantial and effective competition with other products of the same general class in the relevant market or markets." We do not perceive any potential competitive harm. Accordingly, we conclude that section 15.05(d) of Texas Free Enterprise and Antitrust Act is not repugnant to section 7 of the Clayton Act or the Soft Drink Interbrand Competition Act and therefore is not preempted. The first assignment of error is sustained.

We next review the trial court's ruling that TEX.BUS. & COM.CODE ANN. § 15.05(d), Texas Free Enterprise and Antitrust Act, is unconstitutional under the commerce clause of the United States Constitution. U.S. CONST. art. I, § 8, cl. 3 provides that the Congress shall have power:

> [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes, ...

The commerce clause of the U.S. Constitution was designed in part to prevent trade barriers that had undermined efforts of the fledgling states to form a cohesive whole following their victory in the revolution. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 807, 96 S.Ct. 2488, 2496, 49 L.Ed.2d 220 (1976). The review of constitutional questions involving the supremacy clause and the commerce clause are interrelated. Thus the precise question that the Texas antitrust statute unconstitutionally burdens interstate commerce is reviewable under the same standard. In *National City Lines, Inc. v. LLC Corp.*, 687 F.2d 1122 (8th Cir.1982), the court found that the Missouri Takeover Act was invalid under the supremacy clause and the commerce clause. *See also Matuszak v. Houston Oilers, Inc.* 515 S.W.2d 725, 728 (Tex.Civ.App.—Houston [14th Dist.] 1974, no writ).

[6] A state is not generally prohibited from giving effect to its antitrust laws because the regulation affects interstate commerce. *Standard Oil Co. v. Tennessee*, 217 U.S. 413, 30 S.Ct. 543, 54 L.Ed. 817 (1910); *M.I.I. v. E.F.I., Inc.*, 550 S.W.2d 401, 404 (Tex.Civ.App.—Houston [14th Dist.] 1977), *cert. denied*, 435 U.S. 1008, 98 S.Ct. 1879, 56 L.Ed.2d 390 (1978). In this case both sides agree that the question of whether the Texas antitrust law at issue imposes a burden on interstate commerce should be reviewed under the test promulgated by the U.S. Supreme Court in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970):

> Where the statute regulates evenhandedly to effectuate a legitimate local public

> interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.
>
> * * * * * *
>
> [T]he extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

The case at bar raises several questions: (1) Does the challenged state statute impose a burden on interstate commerce; (2) If so, is that burden clearly excessive; (3) What is the nature of the local interest; and (4) Could that local interest be promoted with lesser impact on interstate activities.

In *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 98 S.Ct. 2207, 57 L.Ed.2d 91 (1978), the Supreme Court addressed some of these questions. In that case, a Maryland statute prohibited producers or refiners of petroleum products from operating retail service stations within the state and required that the producers or refiners extend voluntary price reductions uniformly to all service stations supplied. The Maryland statute was challenged under the commerce clause. The Court stated:

> The fact that the burden of the divestiture requirements falls solely on interstate companies ... does not lead, either logically or as a practical matter, to a conclusion that the State is discriminating against interstate commerce at the retail level.... *[W]e cannot adopt appellants' novel suggestion that because the economic market ... is nationwide, no State has the power to regulate* the retail marketing of gas.
>
> * * * * * *
>
> [T]his Court has only rarely held that the Commerce Clause itself pre-empts an entire field from state regulation, and then only when a lack of national uniformity would impede the flow of interstate goods.
>
> * * * * * *
>
> In the absence of a relevant congressional declaration of policy, or a showing of a specific discrimination against, or burdening of, interstate commerce, we cannot conclude that the States are without power to regulate in this area.
>
> * * * * * *
>
> [I]f an adverse effect on competition were, in and of itself, enough to render a state statute invalid, the States' power to engage in economic regulation would be effectively destroyed.

Appellant argues that the issuance of territorial licenses by the two nationwide soft drink companies and the movement of syrup and other materials clearly involve interstate commerce and affect the supply and demand relationship of the interstate market in these goods. They further contend that the Attorney General of Texas "may halt indefinitely" a nationwide merger if he finds the Texas portion in violation of the Texas statute and that there is a possibility that the statute is being applied unconstitutionally. "This sort of hypothetical conflict is not sufficient to warrant preemption." *Exxon v. Governor of Maryland, supra,* at 131, 98 S.Ct. at 2216.

[7] In this case it is undisputed that the relevant federal acts do not contain the required congressional declaration of policy which specifically prohibits state activity. There was no specific showing that the burden on interstate commerce, if any, was clearly excessive or that the Texas antitrust laws has a demonstrable effect on the interstate flow of goods. Without such a showing, we can only conclude that the Texas statute has a rational relationship to a legitimate State interest, i.e., the maintenance and promotion of economic competition in trade and commerce occurring wholly or partly within the state. Accordingly, we hold that the trial court erroneously held that TEX.BUS. & COM.CODE ANN. § 15.05(d) was unconstitutional under the commerce clause.

The judgment is reversed and the cause remanded.

CADENA, Chief Justice, concurring.

I concur in the result, since the challenged order is one sustaining special exceptions to the pleading of the State of Texas. I find nothing in such pleadings which support the trial court's conclusion that the Texas statute is unconstitutional. Any determination of the validity or invalidity of the Texas statute necessarily rests on the facts of the case. I would make no sweeping declarations concerning the validity of the statute in the absence of evidence establishing the effect of the challenged transaction as applied to the facts of this case. It is not the office of a special exception to obtain a ruling based on facts not established by the challenged pleading. The Texas statute is not unconstitutional on its face, and the pleaded facts are insufficient to support a finding of unconstitutionality.

CANTU, J., joins.

Senator METZENBAUM. Thank you very much. I might say that the entire statements of each of the witnesses will be included in the record, even though we limit them to five minutes.

I am going to hear from each of the witnesses first before we have any inquiries. Mr. Gellhorn, we are happy to welcome you again, sir.

Mr. GELLHORN. Thank you very much, Mr. Chairman. In light of the inclusion of my entire statement in the record, I will focus my remarks on the most important issues.

The first issue is what is the need which this legislation seeks to address? The need is simply stated. Contrary to some statements submitted to the committee, the law on non-price vertical restraints is, to quote Professor John Flynn of the University of Utah, "in disarray."

If you read the cases coming out of the lower courts, they do not know how to apply the *Sylvania* rule-of-reason standard because it opens up the record to everything. It is for that reason that the Supreme Court on June 8th took certiorari in one more case to try once again to clarify the law of non-price vertical restraints. This is the case of *Business Electronics Corporation* v. *Sharp*. However, I must say, in light of the Court's last effort in *Monsanto* in 1984, I have little hope that they will clarify the law.

Second, what does this bill do? This bill is a specifically focused, narrow response to the issue of clarification, and nothing else. I am sorry, Mr. Chairman, but I must respectfully disagree with your analysis of S. 567 as well as the statement of Mr. Rule, the assistant attorney general on antitrust This bill is not an exemption; this is not special interest legislation.

All that this legislation (S. 567) does is say that the antitrust laws will be interpreted in a clear and direct fashion. Simply put, it would provide that where there is competition in vertical distribution restraint areas, there is no need to apply the antiturst laws, for the reason that competition will protect the consumer.

If, on the other hand, there can be no showing that substantial and effective competition applies, there would be no change in the application of the antitrust laws under S. 567. This bill would have no effect, for example, on the state of Ohio where state law mandates that exclusive territories shall be adopted by every brewer.

S. 567 would, however, give other states a choice and allow the marketplace to determine whether or not exclusive territories are desirable. What this bill does is provide a tried and true remedy, one that was adopted by Congress in 1980 in softdrinks, to establish a threshold test, to say that litigation which is costly to business should be applied where it is likely to raise a serious question of potential competitive harm where there is no substantial and effective competition. But where that competition is present, there is no reason to have costly litigation.

Now, how does this bill work? I would suggest you take a look at the 1980 Soft Drink Act. In July of 1986, the Attorney General of New York brought his lawsuit against New York beer wholesalers and brewers. That lawsuit is still going. We have not even gotten to litigation on the merits. Mr. Abrams is on one side of that case and I am on the other, and I want the record clearly to show that.

We are currently finding out whether or not we are going to be able to consolidate the hearing, and we had an argument two weeks ago in Boston before the multi-district panel to determine whether or not consolidation should occur.

I have estimated for my client that that case will take two, maybe 5 years. Contrast that case with a case brought by the Pennsylvania Attorney General challenging soft drink exclusive territories in that State, a case filed on December 22nd.

Within four months, on April 28th, the Federal district court dismissed the litigation in Pennsylvania. Why? Because the plaintiff had failed to demonstrate that there was not effective and substantial competition. Indeed, the defendants had demonstrated to the court's full satisfaction that substantial and effective competition was present, and therefore an antitrust trial, one, would have been useless and, two, was precluded by the statute.

This is not, in other words, broad-brush legislation. This is narrowly focused, specific legislation addressing a particular and serious problem.

Now, what about the so-called claims that prices will rise? I must say that looking at the studies such as that offered now by Mr. Abrams leaves me astonished. Let me point out some of the difficulties of his argument.

He argues that you do not want this legislation on beer because beer prices rose higher in New York, supposedly—and I put "supposedly" around it—in contrast to soft drinks, even though it was during this period, of course, that soft drinks were protected, arguably, by the Soft Drink Act of 1980. I would assume that if Mr. Abrams' argument was valid, we would have seen the opposite.

The second point in connection with his study is that he gives us a study of so-called retail prices, but the legislation before us relates only to wholesaler practices, not retailer practices. Until Mr. Abrams provides a credible wholesale price survey, such as Mr. Tollison has done, I would suggest that Professor Tollison's study is the one that has merit.

Third, Mr. Abrams points to a 1976 statement as the basis to conclude that we do not need this legislation. But, Mr. Chairman, in 1976 the Supreme Court had a rule that exclusive territories were per se illegal. That is not the *Sylvania* rule after 1977. And it is the confusion generated by that case and the litigation that has followed which justifies adoption of S. 567.

I will be happy to answer any questions.

[Prepared statement follows:]

SUMMARY OF TESTIMONY BY ERNEST GELLHORN ON S.567

S.567 would require that antitrust lawsuits challenging exclusive territories in malt beverage distribution meet a simple threshold test: where "substantial and effective competition" assures that geographic limitations cannot injure competition or consumers, the antitrust laws would not apply to such agreements.

The Malt Beverage Interbrand Competition Act (S.567) should be adopted because:

- o It would make clear what is now confused, namely that the rule of reason legal standard for exclusive territorial agreements has no relevance where substantial and effective competition exist.
- o It would eliminate needless litigation and relieve both courts and small businesses of the excessive burden of expensive and wasteful lawsuits.
- o It would intensify competition among beer distributors giving consumers the benefit of better service and lower prices.
- o It would preserve states' rights by fully recognizing each state's choice on whether to permit or deny exclusive territories or by allowing states to delegate that decision to the marketplace.

In clarifying the legal standard applied to exclusive territories in beer distribution, S.567 does not exempt the industry from the antitrust laws. The "substantial and effective competition" standard has already proved itself in the soft drink industry where it has worked to reduce litigation costs while competition has been increased. The proposed Malt Beverage Act is fully consistent with Congress' historic role of assuring that the laws are properly interpreted.

Testimony of

ERNEST GELLHORN

on

S.567

The Malt Beverage Interbrand Competition Act

Mr. Chairman, I appreciate the opportunity to appear today before the Antitrust Subcommittee of the Senate Judiciary Committee to testify concerning the Malt Beverage Interbrand Competition Act of 1987 (S.567). I currently serve as the managing partner of the law firm of Jones, Day, Reavis & Pogue in Washington, D.C.

My interest in the question of vertical restraints and the issues raised by the proposed legislation, however, was developed first as a law professor at Duke University and the University of Virginia, and subsequently as dean of the law schools at Arizona State University, the University of Washington, and Case Western Reserve University. During this time, my principal areas of teaching and writing have been antitrust and administrative law. In recent years, I have examined the issues associated with application of the rule of reason to non-price vertical restaints in a law review article published by the Case Western Reserve Law Review. See Gellhorn & Tatum, Making Sense Out of the Rule of Reason, 35 Case W. Res. L. Rev. 155 (1984).

The Judiciary Committee's consideration of the legal standard to be applied to vertical restraints such as exclusive territorial franchises dates back over a decade, to the initial Congressional consideration of the Soft Drink Interbrand Competition Act of 1980. The Soft Drink Act raised the same legal issues and applied the same legal standard as the proposed Malt Beverage Act under consideration today. I testified in support of the soft drink legislation as a necessary clarification of the law of vertical restraints. I have similarly testified at prior hearings in favor of the Malt Beverage Act. The only differences I have seen over this period is that the application of the antitrust laws has become more confused and that the case for antitrust clarification is stronger than ever.

On the other hand, because of the passage of time and assumed familiarity with the Malt Beverage Act, the various policy choices and key issues raised by the proposed bill may have become obscured. My hope today is to identify the primary issues and to present them in a comprehensive framework.

The principal problem addressed by the Malt Beverage Act is that of uncertainty. Ever since the Supreme Court's decision in Continental TV, Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977), the legal status of distributional restraints, including the legality of exclusive geographic territories, has been unclear. By holding that such restraints were not per se unlawful but rather subject to a rule of reason analysis in which procompetitive effects would be balanced against anticompetitive injury, the uncertain contours of the Sylvania test opened up a floodgate of litigation. While this litigation has been largely unsuccessful in establishing antitrust liability for the use of vertical restraints, the legal expenses and other costs incurred by small businesses forced to defend themselves against ultimately baseless charges have been almost as devastating.

This, in its simplest form, is the problem that the Malt Beverage Act attempts to address. The legal uncertainty that currently characterizes the use of vertical distribution practices, including exclusive territorial franchises, threatens to paralyze competition in distribution. American businesses should not be precluded from using the distribution system of their choice because of needless legal uncertainty. Nor should the American consumer be forced to pay for unnecessary legal costs or the increased prices associated with less efficient systems of distribution.

In considering the Malt Beverage Act there are, it seems to me, three questions that should be answered. First, is there a need for this legislation? This includes consideration not only of the seriousness of the problem, but also whether it deserves legislative resolution. Second, is the legislation likely to prove effective in addressing this need? Here the lessons of the Soft Drink Act are particularly instructive. Finally, do these benefits outweigh any other effects that might argue against passage? New legislation must pass a rigorous cost/benefit test.

After careful review, I believe that this Committee must conclude that the answers to each of these questions is yes and that sound public policy requires passage of the Malt Beverage Act.

I. The Antitrust Laws Governing The Use Of Exclusive Territories In The Beer Industry Are Uncertain And Unduly Burdensome.

In considering whether the proposed Malt Beverage Act is needed, it is necessary to step back and review the current legal standard applicable to non-price vertical restraints such as exclusive territories. The critical event occurred ten years ago when the Supreme Court in Sylvania reversed a doctrine that had made it automatically illegal for manufacturers to restrict the geographic territories in which their dealers or distributors sold their products. The Court recognized that such territorial limitations were often -- indeed usually -- of benefit to competition and consumers. It therefore ruled that geographic restrictions should be tested under a rule of reason standard and should no longer be per se unlawful.

In rejecting per se illegality, however, the Supreme Court provided virtually no guidance to lower courts or businessmen on how the rule of reason was to be applied. On the one hand, it recognized that territorial restrictions were to be given sympathetic consideration because they could be used to further competition while, on the other hand, it noted that vertical arrangements could in narrow circumstances harm competition. Nonetheless, the Court's emphasis was on the benefits that could flow from non-price vertical agreements. A substantial list of benefits was identified. For example, by protecting marketing and promotion efforts, territorial restraints help new firms to enter markets and encourage existing firms to intensify their competitive efforts. Interbrand competition among producers of the same generic product is, the Court explained, "the primary concern of the antitrust laws."

Where and how the line of legality should be drawn between likely beneficial and possibly harmful practices was not clearly identified, however. In fact, the Court did little to spell out the meaning or application of the rule of reason test. It merely quoted from an earlier decision in Chicago Board of Trade v. United States, 246 U.S. 231 (1918), that vaguely identified some of the factors that should be considered in determining whether a territorial limitation violated the antitrust laws.

At the time, legal scholars predicted that the rule of reason standard would prove difficult to apply in the context of vertical restraints. For example, shortly after the Sylvania decision was announced, Professor Robert Pitofsky, now dean of Georgetown University Law Center, wrote: "[T]he technique followed [in Sylvania] of citing a paragraph of generally framed factors from a 1918 case, with no indication of how and why any particular factor is relevant or the priority and relative weight to be accorded to each, will surely breed further confusion and litigation in this area." Pitofsky, The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions, 78 Colum. Law Rev. 1, 11 (1978).

Actual experience during the ten years since the Sylvania decision has more than demonstrated the validity of Dean Pitofsky's concerns. Nor has the Supreme Court taken advantage of subsequent opportunities to spell out the manner in which the rule of reason standard was to be applied. It declined to provide additional guidance in its most recent vertical restraints decision, Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984). And lower court decisions, particularly jury verdicts, have generally confused rather than clarified the standard. See, e.g., Business Electronics Corp. v. Sharp Electronics Corp., 780 F.2d 1212 (5th Cir. 1986)(citing cases), cert. granted, No. 85-1910, 55 U.S.L.W. 3820 (U.S. June 8, 1987).

The result is that the law is both untidy and unclear. As one antitrust scholar summarized the current case law: "One cannot survey the post-Monsanto litigation without concluding that the law [of vertical restraints] is presently in a state of disarray." Flynn, The "Is" and "Ought" of Vertical Restraints After Monsanto Co. v. Spray-Rite Service Corp., 71 Cornell L. Rev. 1095, 1148 (1986).

In the meantime, and as a direct result of confusion regarding the antitrust law in this area, the number and magnitude of lawsuits challenging non-price vertical agreements have increased markedly in recent years. See Business Electronics, supra. For judges and lawyers, this may not necessarily be a bad thing, since debating the meaning of the rule of reason in vertical non-price cases is intellectually challenging and rewarding. For businessmen, however, the legal uncertainty is expensive, time-consuming and worrisome. Either they seek the efficiencies of exclusive territories and risk disruptive lawsuits, or they seek a quieter life and risk losing business to other, often larger competitors. Unfortunately, it is the American consumer who is the real loser.

The danger of antitrust litigation caused by this uncertainty is particularly acute in the beer distribution industry. Use of territorial restraints is common in this industry, and indeed exclusive territories are mandated by statute in 27 states (and forbidden in only one). In recent years, the leading national brewers have turned increasingly to the use of exclusive territories, recognizing both the competitive benefits such territories confer and the desirability of maintaining a uniform nation-wide system of distribution. In so doing, however, they and their distributors face the prospect of excessive legal challenges to the use of exclusive territories in the 22 states that have not legislated on this issue.

In the last year, the potential liability associated with the use of exclusive territories was graphically demonstrated by a major test case filed by the New York state attorney general challenging the use of exclusive territories in beer distribution in New York state under federal and state antitrust laws. New York v. Anheuser-Busch et al., No. CV-86-2345 (E.D.N.Y., filed July 15, 1986).* The attorney general's lawsuit was almost immediately followed by the filing of five separate private damage actions. Each of these lawsuits asks for class certification, treble damages and attorneys' fees.

Under the current state of the law, these cases are unlikely to be resolved quickly or even with reasonable dispatch. A lengthy "rule of reason" trial may well result, even though beer distribution markets are generally competitive and exclusive territorial arrangements are likely to enhance efficiency, increase interbrand competition and often lower prices to consumers. The problem is that there is no current device available to screen out those cases where vertical arrangements are likely to be beneficial, leaving for trial only those where competition could be seriously harmed. As a result, society's resources are wasted, consumers are badly served by the legal system, and legitimate business practices are interrupted. There is, in other words, a serious problem here that deserves Congressional relief.

II. The Malt Beverage Act Would Serve The Public Interest By Clearing Up The Uncertainty That Clouds Legitimate Uses of Vertical Agreements.

The Malt Beverage Act represents a simple and straightforward solution to the problem of uncertainty concerning the legal status of non-price vertical agreements. It provides that such arrangements could continue to be challenged under the rule of reason where there is a serious risk of potential harm to competition, namely when a court finds that "substantial and effective competition" is not present to protect the market. But where such competition exists, unnecessary antitrust trials could be eliminated.

The proposed bill follows the decision made by Congress in enacting the the Soft Drink Interbrand Competition Act of 1980. There Congress determined that the benefits of vertical arrangements such as territorial limitations outweighed the costs when "substantial and effective competition" is found.

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*I wish to note that I am counsel of record to the New York State Beer Wholesalers' Association, Inc. in this case.

The rationale for the Malt Beverage Act is simple and straightforward. Where markets are competitive, neither brewers nor distributors could raise prices above market levels or engage in other anticompetitive conduct without risking the loss of a substantial share of the market. The potential risk of price-fixing or other illegal acts, emphasized by the bill's doubters, is minimal where consumers have readily available alternatives. Thus, there is no basis for an antitrust challenge when such vigorous competition is present.

Contrary to some untutored assumptions, S.567 would not exempt the beer industry from the antitrust laws. Instead, it would apply a threshold test to limit antitrust challenges only to non-price vertical restraints such as exclusive territories, to those cases where there is a realistic danger of injury to competition. Such cases could continue without change and vertical agreements in this circumstance would continue to be scrutinized under the rule of reason test enunciated in Sylvania. In addition, S.567 specifically provides that it does not apply to horizontal price-fixing and boycotts or similar horizontal conduct, because s[illegible] conduct (unlike vertical non-price restraints) generally carries with it a serious risk of consumer injury.

The screening mechanism adopted in the Soft Drink Act and proposed in S.567 (that exclusive territories would be lawful where "substantial and effective competition" is found) represents a simple yet effective standard to eliminate needless litigation. Where vertical restrictions in the beer industry could be said to pose a threat to competition -- in particular, where competition is not substantial or effective or where the restriction involves more than a vertical restraint -- the provisions of S.567 would not apply and traditional antitrust rules would govern.

As noted, this test is borrowed from the Soft Drink Act of 1980. In the seven years since its enactment, the soft drink law has proven its effectiveness in clarifying the legal analysis to be applied to vertical restraints in soft drink distribution. Before the Soft Drink Act was passed, numerous lawsuits challenging exclusive territories had been filed in the industry, including one by the Federal Trade Commission. On the other hand, claims were made that the bill would exempt the soft drink industry from the antitrust laws and would insulate soft drink manufacturers and distributors from competition. This has not happened as recent years have seen, if anything, increasing competitive pressures in this industry.

What has occurred as a result of the Soft Drink Act's passage, however, is a significant reduction in the number of antitrust claims challenging soft drink distribution practices, particularly when compared to factually analogous industries such as beer distribution. Moreover, those claims which have been filed have been resolved speedily by reference to the provisions of the Soft Drink Act.

The effectiveness of the Soft Drink Act in resolving litigation claims was demonstrated dramatically this year when a federal district court dismissed a lawsuit brought by the Pennsylvania state attorney general challenging the use of exclusive territories by Pepsico and its bottlers and the enforcement of those territories through prohibitions against transshipping at the retail level. Commonwealth of Pennsylvania v. Pepsico, Inc., 658 F. Supp. 816 (M.D. Pa. 1987). The lawsuit had alleged that Pepsico and its bottlers (who distributed Pepsico products through exclusive geographic franchises) had improperly forced retailers to buy Pepsi products only from their local bottlers.

Pepsico and its bottlers moved to dismiss the complaint on the grounds that the use of exclusive territories was expressly permitted by the Soft Drink Act so long as there was "substantial and effective competition." The district court agreed that the Act's standard was met and that the use of exclusive territories was not forbidden by the antitrust laws.

It therefore upheld Pepsico's ban on transshipping, even at the retail tier, in enforcing its lawful exclusive territories.

The Pepsico decision is important for its recognition of the lawfulness of exclusive territories. For this hearing, however, it also provides positive proof that the screening mechanism contained in the Soft Drink Act (and proposed under the Malt Beverage Act) will in fact work to reduce unwarranted judicial burdens and litigation expenses now imposed on small businesses in the beer industry. The complaint in Pepsico was filed on December 22, 1986. The defendants responded by moving to dismiss the complaint on the basis of the Soft Drink Act. After receiving briefs on the legal issue of the Act's applicability, the district court dismissed the complaint on April 28, 1987, just four months after it was filed. With clear guidance from Congress on the applicability of the antitrust laws, the trial court could act speedily and decisively. This is exactly what Congress intended when it approved the Soft Drink Act.

The Pepsico decision also provides a dramatic contrast to the progress of litigation involving almost identical issues in the beer industry. The Anheuser-Busch lawsuit brought by the New York state attorney general challenging the use of exclusive territories for beer distribution in that state was filed on July 15, 1986, just over a year ago. While the New York beer litigation has already lasted three times longer than the Pennsylvania soft drink litigation, the parties are still several years away from any decision on the merits. Efforts to date in the New York lawsuit have focused on such preliminary but time consuming issues as the certification of plaintiff and defendant classes. In the absence of a Congressional directive as to the legal standard to be applied (such as that which would be provided by the Malt Beverage Act), defendants have been unable to make a dispositive motion with respect to the merits of the claims raised -- even though the economic evidence suggests that competition in the beer industry is even more intense that it is in the soft drink field.

Given the demonstrated effectiveness of the Soft Drink Act, the arguments for passage of the Malt Beverage Act are, if anything, even more compelling, since 27 states have already passed legislation mandating the use of exclusive territories for beer distribution. The current uncertainty creates the anomalous possibility of conduct being required by one state being found unlawful in another.

III. The Arguments Advanced In Opposition To The Malt Beverage Act Are Unpersuasive And Do Not Militate Against Its Passage.

During the years that the Malt Beverage Act has been considered by this body, a number of arguments have been advanced in opposition to its passage. Many of these concerns are factually erroneous, and none outweigh the public benefits that would be achieved by enactment.

The Department of Justice questioned the Malt Beverage Act, as it did the Soft Drink Act, on the ground that it could be interpreted as exempting the industry from the antitrust laws. However, the specific language of the Act -- establishing a threshold test for exclusive territorial agreement and continuing prohibitions on horizontal price-fixing and boycott -- fully answers this concern.

This question does point out another advantage of the Malt Beverage Act. It is usually wise to experiment with changes to basic laws in a specific context to see how they work. The Soft Drink Act demonstrates that this threshold test to the application of the antitrust laws to exclusive territories works as Congress expected. Its application in a second industry, particularly where a majority of the states already mandate such distribution practices, would be another stage in this experiment.

Another concern expressed by some who have questioned the Malt Beverage Act is whether this proposed legislation would invade states rights by altering existing state statutes regulating beer distribution. The answer to this question is that this bill would not impair state interests. To the contrary, it would enhance states' rights by increasing the range of choices available to states in mandating, prohibiting or allowing exclusive territories. Passage of the Malt Beverage Act would not affect any state enactments because Section 7 of S.567 specifically provides that the Act does "not invalidate or affect any provision of the laws of any State." That is, state laws which require or prohibit exclusive territories -- whether they are on the books now or are adopted in the future -- would remain untouched.

The Malt Beverage Act would further enhance states' rights by giving states a choice they do not now have. At present, states cannot safely leave the question of whether exclusive territories are appropriate to brewers and beer distributors. If they have no law on the books (or were to pass a law specifically leaving it to the brewers and distributors), the antitrust laws could be applied to deny that choice. Neither of the current alternatives of approving or prohibiting exclusive territories allow a state to leave the choice to the marketplace and the judgment of individual brewers and wholesalers. The Malt Beverage Act would provide that option.

Opponents have also asserted that the beer industry is an unduly concentrated industry and therefore conducive to horizontal price-fixing and similar activities. Thus, they argue, vertical restrictions including exclusive territories should not be approved because they could aid cartel activities. While their theory is sound, neither their factual understanding of the industry nor their analysis of the Malt Beverage Act is accurate.

The beer industry is intensely competitive and increasingly so today. A 1978 FTC staff study made this finding and it is further supported by Dr. Tollison's recent examination. See FTC Staff Study, The Brewing Industry (1979); Tollison & Ekelund, The Economic and Welfare Efficiency of Geographic Restraints in the Malt Beverage Industry 8 (1987)(graphically detailing the increase in the number of U.S. breweries since 1982). The industry leaders of the early 1970s, Schlitz and Pabst, have almost disappeared; Miller and Strohs have come to the fore through new product offerings (lite beers) and clever promotion. Real beer prices have in fact been declining

--especially where exclusive territories are protected and price advertising is allowed. These are the indicia of a competitive market.

In any case, the argument that the Malt Beverage Act would facilitate collusion is a erroneous. It ignores the specific provisions of the bill making it applicable only after a judicial finding that "substantial and effective competition" is present. It further ignores the provisions of Section 3 of the Act that provides that it shall not:

> [B]e construed to legalize the enforcement of provisions . . . in any written contract . . . by means of price-fixing agreements, horizontal restraints of trade, or group boycotts, if such agreement, restraints, or boycotts would otherwise be unlawful.

The experience under the Soft Drink Act has demonstrated that courts are fully capable of identifying the proper scope of the Act's coverage.

IV. Conclusion

I believe that S.567 addresses a real need in beer distribution and that its passage would benefit beer distributors, brewers and consumers. It proposes a tried and true remedy that has worked well in the soft drink industry. The effect of S.567 is clear. It would remove the uncertainty created by the *Sylvania* case and clarify the law that is in such "disarray."

Enacting the Malt Beverage Act would promote states' rights by eliminating the double standard that now characterizes antitrust rules governing the beer industry. The Act would allow states the freedom to make decisions concerning beer distribution -- either by mandating/prohibiting exclusive territories or by leaving it to brewers and distributors -- without having their decisions constrained by potential federal antitrust liability.

Enactment of the Malt Beverage Act is also consistent with Congress' historic role in assuring that the laws are properly interpreted. The antitrust laws are open-ended and deliberately vague because it is impossible to identify all business practices or predict which will be harmful. But as we learn from experience of practices that are likely to increase competition and benefit consumers, they should be protected from unwarranted antitrust challenge. That is exactly what S.567 would achieve. I therefore urge its approval.

August 4, 1987

[5] To hold that petitioner is the charterer in these circumstances, the Court would have to find that Stellar is petitioner's alter ego. Petitioner states that Stellar, a co-subsidiary, booked a ship on its behalf, but does not allege that Stellar had "no separate mind, will, or existence of its own." *Fisser*, 282 F.2d at 238.[6] Superficial factors indicating that two corporate entities are related do not dispose of the alter ego question. *Coastal*, 446 F.Supp. at 334. It is more important to know whether the controlling corporation dominates the finances, policy, and business practices of the controlled corporation. The fact that Stellar booked ships for subsidiaries of Continental Grain does not suggest that it is a "puppet" of those subsidiaries. In fact it is more likely "that the degree of control necessary to invoke the alter ego doctrine would be exercised by a parent over its subsidiaries, rather than by one subsidiary over another." *See Coastal*, 446 F.Supp. at 337.

The Court concludes that petitioner cannot be included within the definition of the term "charterer." Therefore, the dispute between the parties is not encompassed within the scope of the NYPE arbitration clause.

CONCLUSION

In sum, petitioner cannot establish that either it or respondent is bound to resolve its disputes under the arbitration clause of the subcharter.[7] Accordingly, the petition must be denied.

So ordered.

COMMONWEALTH OF PENNSYLVANIA, ex rel. LeRoy S. ZIMMERMAN, Attorney General of Pennsylvania, Plaintiff,

v.

PEPSICO, INC., Allegheny Pepsi-Cola Bottling Co., Inc., and Confair Bottling Co., Inc., Defendants.

Civ. A. No. 86-1799.

United States District Court,
M.D. Pennsylvania.

April 28, 1987.

Commonwealth brought antitrust action as parens patriae against bottler and manufacturer of soft drink syrup. The District Court, Caldwell, J., held that actions of bottlers and manufacturer designed to limit sales of product to resellers who would sell only to the ultimate consumer and not to those who would sell to other resellers outside the territory was lawful under the Soft Drink Interbrand Competition Act.

Judgment for defendant.

1. **Monopolies ⟸12(5)**

Standing alone, provision of the Soft Drink Interbrand Competition Act exempting certain trademark licensing agreements from antitrust laws would make lawful practices of soft drink manufacturer and bottlers designed to preclude retailers from shipping product outside of their territory. Soft Drink Interbrand Competition Act, § 2, 15 U.S.C.A. § 3501.

2. **Monopolies ⟸12(2)**

Bottlers' use of coding system to trace product to individual bottlers and syrup manufacturer's imposition of fines on bottlers whose product was shipped or sold out of the territory by resellers were lawful under the Soft Drink Interbrand Competition Act since they were used to enforce legal ban on resales. Soft Drink Interbrand Competition Act, § 2, 15 U.S.C.A. § 3501.

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[6] Since the Court holds below that neither petitioner nor respondent is bound by the NYPE arbitration clause, it does not believe that a motion to amend the pleadings would be productive.

[7] In view of the Court's holding, it is unnecessary to consider respondent's further argument for dismissal on *forum non conveniens* grounds.

3. Monopolies ⇔17(1.3)

Both manufacturer of soft drink syrup and bottlers could legally prohibit sales to resellers designed to control transhipping by resellers to another territory, and did not violate Soft Drink Interbrand. Competition Act since they were used to enforce legal ban on resales. Soft Drink Interbrand Competition Act, § 2, 15 U.S.C.A. § 3501.

4. Monopolies ⇔17(1.3)

Conduct of soft drink syrup manufacturer and bottlers in attempting to preclude resellers from shipping product outside their territory was not an impermissible horizontal conspiracy. Soft Drink Interbrand Competition Act, § 3, 15 U.S.C.A. § 3502.

5. Monopolies ⇔17(2.2)

Practice of bottlers in refusing to deal with resellers who would otherwise sell to other resellers so as to exclude resellers from entering the wholesale market for the soft drink was made lawful by the Soft Drink Interbrand Competition Act. Soft Drink Interbrand Competition Act, § 2, 15 U.S.C.A. § 3501.

6. Evidence ⇔5(2)

Court could take judicial notice that agreement between soft drink manufacturer and bottlers was a trademark licensing agreement for purposes of the Soft Drink Interbrand Competition Act. Soft Drink Interbrand Competition Act, § 2, 15 U.S.C.A. § 3501.

Eugene F. Waye, Carl S. Hisiro and Kelly H. Greensmith, Deputy Attys. Gen., Office of Atty. Gen., Antitrust, Harrisburg, Pa., for Com.

Gerard W. Casey, Purchase, N.Y., Rod J. Pera, Alan R. Boynton, Jr., McNees, Wallace and Nurick, Harrisburg, Pa., for Pepsico, Inc. & Allegheny Pepsi Cola Bottling Co.

J. David Smith, McCormick, Reeder, Nichols, Sarno Bahl & Knecht, Williamsport, Pa., Fred A. Freund, Richard M. Steuer, Kaye, Scholer, Fierman, Hays & Handler, Hughes Hubbard & Reed, James B. Reed, New York City, for Confair Bottling Co.

MEMORANDUM

CALDWELL, District Judge.

I. *Introduction.*

Defendants, PepsiCo, Inc. (PepsiCo), Allegheny Pepsi-Cola Bottling Company, Inc. (Allegheny) and Confair Bottling Company, Inc. (Confair), have filed motions to dismiss the amended complaint. The Commonwealth of Pennsylvania brought this antitrust action as *parens patriae*, alleging violation of section 1 of the Sherman Act, 15 U.S.C. § 1, and seeking an injunction against certain practices of the defendants pursuant to the Clayton Act, 15 U.S.C. § 26. In ruling upon the motions, we must accept as true all well-pleaded allegations of the complaint and construe them liberally in the light most favorable to the plaintiff. *See Labov v. Lalley*, 809 F.2d 220 (3d Cir.1987).

II. *Background.*

The amended complaint sets forth the following allegations. PepsiCo manufactures soft drink syrup and concentrate which it sells to, among other bottlers, Allegheny and Confair. The latter defendants have licensing agreements with PepsiCo which authorizes them to produce, package, and sell carbonated Pepsi-Cola soft drinks to so-called "resellers," consisting of beer and soda distributors, restaurants, taverns, bars, vending companies, grocery stores, department stores and drug stores. Allegheny and Confair have been granted exclusive geographic territories in which to sell PepsiCo products.

The complaint charges that the defendants have engaged in a horizontal conspiracy to restrain trade by preventing resellers from making sales of Pepsi-Cola products to each other. Specifically, defendants have engaged in the following practices: (1) using coding systems so that soft drink products can be traced and monitored; (2) fining bottlers for product shipped or sold out of their territory by resellers; (3) refusing to deal with resellers who buy or sell soft drinks outside the territory in which the reseller is located; (4) refusing to deal with resellers which buy or sell soft drinks to or from other resellers located in the same bottling territory; (5) combining with resellers not to sell soft drink to other resellers and threatening to terminate them or limit their supplies if they do so; and (6) limiting sales to quantities a reseller needs solely for its own retail sales.

The complaint alleges that resellers often desire to buy and sell to each other because of price differences between the bottlers and because a bottler may even sell product to different resellers at different prices. When resales are made outside the bottler's territory, it is known as "transhipping." *Pepsi-Cola Metropolitan Bottling Co. Inc. v. Checkers, Inc.*, 754 F.2d 10, 12 (1st Cir.1985).

The basis of the motions to dismiss is that the defendants' arrangement is specifically protected by the Soft Drink Interbrand Competition Act (the Act), 15 U.S.C. § 3501. Conversely, plaintiff asserts that its claim is actually one for which the Act carves out an exception in section 3502. After careful consideration we conclude that the Act does immunize defendants' behavior under section 3501 and that the section 3502 exception does not apply.

III. *Discussion.*

The relevant statutory sections are as follows:

> § 3501. Exclusive territorial licenses to manufacture, distribute, and sell trademarked soft drink products; ultimate resale to consumers; substantial and effective competition Nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any trademark licensing contract or agreement, pursuant to which the licensee engages in the manufacture (including manufacture by a sublicensee, agent, or subcontractor), distribution, and sale of a trademarked soft drink product, of provisions granting the licensee the sole and exclusive right to manufacture, distribute, and sell such product in a defined geographic area or limiting the licensee, directly or indirectly, to the manufacture, distribution, and sale of such product only for ultimate resale to consumers within a defined geographic area: Provided, That such product is in substantial and effective competition with other products of the same general class in the relevant market or markets.

15 U.S.C. § 3501.

> § 3502. Price fixing agreements, horizontal restraints of trade, or group boycotts Nothing in this Act shall be construed to legalize the enforcement of provisions described in section 2 of this Act [15 USC § 3501] in trademark licensing contracts or agreements described in that section by means of price fixing agreements, horizontal restraints of trade, or group boycotts, if such agreements, restraints, or boycotts would otherwise be unlawful.

15 U.S.C. § 3502 (brackets added).

As detailed in defendants' brief in support of their motions, this legislation was passed after years of litigation before the Federal Trade Commission which ultimately culminated in an FTC decision that the syrup manufacturers' territorial system, a common practice in the industry for seventy-five years, violated section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1). *See Coca-Cola Co. v. FTC*, 207 D.C.App. 1, 642 F.2d 1387 (D.C.Cir.1981) (per curiam) (declining to exercise appellate review of the FTC's decisions involving the Coca-Cola Co. and Pepsico and, based upon passage of the Act after the FTC decisions, remanding them to the FTC solely for dismissal of the administrative complaints).[1]

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[1] We should note that the court of appeals did not reach the merits of whether the practices investigated by the FTC were lawful under the Act. It merely remanded for dismissal because both sides requested such relief. It expressly

[1] We agree with defendants that, standing alone, section 3501 would make lawful the practices alleged in the amended complaint. The section broadly provides that the antitrust laws shall not apply to any trademark licensing agreement *limiting the licensee directly or indirectly* to the manufacture, distribution and sale of such product *only for ultimate resale to consumers in a defined geographic area.* In the instant case, this section would allow PepsiCo to limit its bottlers to sales of product to those who, in turn, would sell only to the ultimate consumer. Section 3501 would thus make lawful the practices the Commonwealth has complained about; chiefly, the refusal by both bottlers to sell to resellers—those businesses, inside or outside the territory, which would sell not just to the consumer, but to other retailers as well. We agree with defendants that to accept plaintiff's interpretation of the Act—that the Act does not protect limitations imposed upon resellers—would render the Act meaningless.

As noted by defendants, the practices challenged here by the Commonwealth have been found lawful when considered under a rule of reason analysis. For example, in *Sports Center, Inc. v. Riddell, Inc.*, 673 F.2d 786 (5th Cir.1982), a dealer sued Riddell, a manufacturer of football helmets, after the dealer was terminated for "bootlegging" helmets to other retailers. Riddell required its dealers to sell only to ultimate consumers. The jury found in favor of Riddell. Approving of the practice on appeal, the court stated:

> In short, Riddell was entitled to impose and enforce a *reasonable* anti-bootlegging policy. This type of restriction and enforcement "is not equivalent to conspiracy." *Parsons v. Ford Motor Co.*, 669 F.2d 308, at 313 [(5th Cir.1982)] (footnote omitted). Considering Riddell's business reasons for limiting its products distribution to authorized dealers—products liability consequences and improving its competitive position in the market—in combination with its legal right to terminate a retailer, *see Burdett Sound, Inc. v. Altec Corp.*, 515 F.2d 1245 (5th Cir. 1975), we conclude that the district court's direct-verdicts and post-judgment decrees were not in error.

Id. at 791–92 (footnote omitted).

This practice corresponds to PepsiCo's ban on sales to resellers or transhippers.

In another case dealing directly with the soft drink industry and with the problem of transhipping, *Pepsi-Cola Metropolitan Bottling Co., supra*, the court concluded that the Act permitted a bottler to limit its sales to a retailer to prevent the retailer from reselling the product at wholesale. The court stated:

> To be sure, Randolph [the transhipper] asserts in mitigation of his conduct that Pepsi and Metropolitan [the bottler] were themselves guilty of unfair and wrongful conduct in refusing to sell to his company all the product it desired. Defendants contend that since appellee engaged in questionable practices with respect to defendants, defendants' retaliatory refusal to pay a preexisting debt was not immoral, unethical, oppressive or unscrupulous. However, to the extent there was any question whether Pepsi-Cola, Inc. and Metropolitan were entitled to limit sales so as to maintain Pepsi's system of exclusive territorial dealerships, their right to do so was bolstered by the Soft Drink Interbrand Competition Act, 15 U.S.C. § 3501, which became effective July 9, 1980, less than three weeks after Randolph first refused to pay. *See Coca-Cola v. FTC*, 642 F.2d 1387 (D.C.Cir. 1981). By the time Randolph deliberately withheld payment, the handwriting was on the wall in this regard.

754 F.2d at 18 (brackets added).

The same result was reached before passage of the Act in *Tomac, Inc. v. Coca-Cola Company*, 418 F.Supp. 359 (C.D.Cal. 1976). There, the court set aside a jury verdict in favor of the plaintiff which had charged the Coca-Cola Company with antitrust violations for refusing to provide plaintiff's bottler sufficient syrup so that the plaintiff could sell to retailers in other bottlers' territories. Noting that the ar-

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avoided deciding whether, under the standard set forth in the Act, the practices were legal rangement plaintiff was attacking was a vertical one rather than horizontal and thus subject to a rule of reason analysis, the court concluded that the exclusive territorial restriction placed upon the bottler was reasonable and promoted a legitimate business purpose by giving the bottler an incentive to invest in plant and equipment. *See also First Beverages, Inc. v. Royal Crown Cola Co.*, 612 F.2d 1164 (9th Cir.), *cert. denied*, 447 U.S. 924, 100 S.Ct. 3016, 65 L.Ed.2d 1116 (1980).

Similarly, in *Davis-Watkins Company v. Service Merchandise*, 686 F.2d 1190 (6th Cir.1982), *cert. denied sub nom., Service Merchandise v. Amana Refrigeration, Inc.*, 466 U.S. 931, 104 S.Ct. 1718, 80 L.Ed.2d 190 (1984), the court affirmed a summary judgment in favor of the manufacturer, Amana Refrigeration, Inc., and one of its distributors, Davis-Watkins Company, on a claim that Amana's exclusive territorial system violated section 1 of the Sherman Act. The restrictions imposed by Amana required distributors to sell only to authorized dealers, the dealers had to be located in the distributor's territory and, most importantly, dealers had to agree to sell only to consumers. Amana enforced its policy by tracking the product, microwave ovens, through its computer system and by offering financial incentives solely to the distributor in whose territory an oven was used rather to the selling dealer or distributor. As a result of this policy, Service Merchandise could no longer obtain Amana microwave ovens for retail sale. The court of appeals concluded that the restrictions were vertically imposed and reasonable, being designed to increase Amana's competitiveness in the interbrand market. Thus, a total ban on transhipping was found to be valid.

[2] The amended complaint sets forth two other practices which are used to enforce the ban on resales and transhipments. One is the use of a coding system to trace product to individual bottlers. The other is the imposition of fines on bottlers whose product is shipped or sold out of their territory by resellers. The first practice corresponds to the computer tracking system used in *David-Watkins, supra*, and the second to the financial incentives from the same case. We view these practices as being legal since they are used to enforce a legal ban on resales.

Plaintiff has complained of one practice which would not appear to be protected by section 3501. Resellers have been prevented from selling to other resellers even when it has not been shown that the purchasers had intended to sell the product outside the territory. If the purchaser sells only at retail inside the territory, it could be argued that the ultimate resale to consumers has occurred within the territory and apparently the plan sanctioned by Congress has not been violated.

[3] We believe, however, that PepsiCo and the bottlers could legitimately prohibit such sales to control transhipping. For example, in *Bruce Drug, Inc. v. Hollister, Inc.*, 688 F.2d 853 (1st Cir.1982), the plaintiff retailers had obtained a preliminary injunction requiring the defendant manufacturer to continue to supply them with its ostomy appliances. The court of appeals reversed the grant of the injunction, concluding that the refusal to deal was a reasonable response to one of the plaintiff's attempts to sell overseas—a territory belonging to another distributor. Responding to one of plaintiffs' arguments, the court stated:

> Bruce contends, very possibly correctly, that by March, 1981, defendant was undertaking to prevent its getting any Hollister products whatever, and asserts this to be an overbroad response. There are two answers to this. One is that Bruce does not suggest how defendant could safely protect itself by doing anything less. While foreign ostomates generally prefer closed pouches, we find nothing in the record to suggest that they use nothing else. It would appear that virtually any box of Hollister products sent to Bruce could, potentially, wind up overseas. Even if not, defendant was not required to adopt the least restrictive means of stopping Bruce from selling abroad, but merely means reasonably suited to that purpose. *American*

> *Motor Inns, Inc. v. Holiday Inns, Inc.*, 3 Cir., 1975, 521 F.2d 1230, 1248–50; *see Continental T.V., Inc. v. GTE Sylvania, Inc.*, 1977, 433 U.S. 36, 58 n. 29, 97 S.Ct. 2549, 2561 n. 29, 53 L.Ed.2d 568. Defendant cannot be faulted for failing to engage in elaborate and possible time-consuming speculation about Bruce's marketing intentions on an order-by-order or box-by-box basis. The court having held, quite properly, that defendant was to be held to nothing stricter than a rule of reason, *Continental T.V., Inc. v. GTE Sylvania, Inc.*, ante; *Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc.*, 1 Cir., 1978, 572 F.2d 883, *cert. denied*, 439 U.S. 833, 99 S.Ct. 112, 58 L.Ed.2d 128, we see no basis for finding that it violated that standard.

Id. at 860.

Buying from another distributor or wholesaler to circumvent the direct refusal to deal by the manufacturer appears to be a common practice. *See Davis-Watkins, supra; Mendelovitz v. Adolph Coors Co.*, 693 F.2d 570 (5th Cir.1982). In turn, manufacturers have responded by cutting off the distributor selling to the transhipper or limiting sales to the distributor's legitimate needs. We conclude that the practice of discouraging sales between resellers is reasonably designed to control transhipping and sanctioned by the Act.

Our conclusion is buttressed by paragraph 19 of the amended complaint which sets forth the reasons why resellers attempt to purchase from other resellers:

> Resellers buy from other resellers because their local bottler charges higher prices. Resellers also buy from each other when their local bottler either refuses to sell Pepsi products to them or refuses to sell Pepsi products to them in sufficient quantities.

The first sentence refers to purchases attempted from resellers in another territory. Under the Act, defendants clearly are authorized to prevent this practice. The second sentence refers to purchases from resellers in the same territory. Specifically, the practice is attempted because the local bottler refuses to supply the reseller at all or sells the reseller insufficient quantities. As defendants correctly point out, "if the factual context renders [a] claim implausible—if the claim is one that simply makes no economic sense—[plaintiff] must come forward with more persuasive evidence to support [its] claim than would otherwise be necessary. *Matsushita Electric Industrial Co. v. Zenith Radio Corporation*, — U.S. ——, ——, 106 S.Ct. 1348, 1356, 89 L.Ed.2d 538, 552 (1986) (brackets added). Plaintiff's claim makes no economic sense. No bottler would refuse to sell to a reseller in the bottler's own territory, or to limit the reseller's supply—unless it was trying to prevent transhipment, in which case the restraint is reasonable and in conformity with the Act. Moreover, plaintiff has not argued presuasively that defendants had any other motive. The bottlers' motive is ostensibly to eliminate competition from resellers in the retail market. But, as we have seen, as between and among territories, the Act authorizes such activity in furtherance of PepsiCo's vertical marketing scheme. And, within a territory, a bottler controls sales and it would make no sense to withhold product which would eventually be sold in its own territory and from which it would profit.

Plaintiff has not attempted to rebut the use of any of the above cases or others cited by defendants. It does not claim that any of them are in error or distinguishable on their facts. Rather, relying principally upon *Cernuto, Inc. v. United Cabinet Corp.*, 595 F.2d 164 (3d Cir.1979), the Commonwealth contends that defendants' cases are simply irrelevant to its claim which is for a *per se* illegal horizontal conspiracy, not a vertical arrangement, among the defendant bottlers and PepsiCo. The plaintiff also asserts that the defendants' refusal to deal with resellers is a group boycott, another *per se* violation of the Sherman Act. *See Cernuto, supra.* Finally, plaintiff cites section 3502 of the Act which excepts from the protection of section 3501 enforcement of trademark licensing provisions by way of price fixing agreements, horizontal restraints of trade or group boycotts.

Plaintiff's reliance upon *Cernuto, supra,* and cases like it, is misplaced. In those cases, the restraint was instigated by the dealers, not the manufacturer at the top of the distribution chain. Thus, for example, in *Cernuto,* plaintiff, a retailer of kitchen cabinets, claimed it was terminated as a dealer by the defendant manufacturer after receiving complaints from another retailer about plaintiff's discount prices. The district court entered summary judgment against plaintiff. Reversing, the court of appeals made a distinction between an apparently vertical restraint and one which was really horizontal in nature. The court stated:

> [I]f the action of a manufacturer or other supplier is taken at the direction of its customer, the restraint becomes primarily horizontal in nature in that one customer is seeking to suppress its competition by utilizing the power of a common supplier.
>
> Therefore, although the termination in such a situation is, itself, a vertical restraint, the desired impact is horizontal and on the dealer, not the manufacturer, level.

Id. at 168 (brackets added).

The court commented on *United States v. General Motors Corp.,* 384 U.S. 127, 86 S.Ct. 1321, 16 L.Ed.2d 415 (1966), another case cited by plaintiff in its support, as follows:

> The importance of the horizontal nature of this arrangement is illustrated by *United States v. General Motors Corp.,* 384 U.S. 127, 86 S.Ct. 1321, 16 L.Ed.2d 415 (1966). Although General Motors, the manufacturer, was seemingly imposing vertical restraints when it pressured recalcitrant automobile dealers not to deal with discounters, the Supreme Court noted that in fact these restraints were induced by the dealers seeking to choke off aggressive competitors at their level, and found a *per se* violation, rejecting the suggestion that only unilateral restraints were at issue. So here, if United and Lappin acted at Famous' direction, both the purpose and effect of the termination was to eliminate competition at the retail level, and not, as in *GTE Sylvania,* to promote competition at the manufacturer level. Accordingly, the pro-competitive redeeming virtues so critical in *GTE Sylvania* may not be present here.

Id. (footnote omitted).

The plaintiff also cites *Malley-Duff & Associates, Inc. v. Crown Life Insurance,* 734 F.2d 133 (3d Cir.), *cert. denied,* 469 U.S. 1072, 105 S.Ct. 564, 83 L.Ed.2d 505 (1984), which presented a similar factual situation. In *Malley-Duff,* the court of appeals, relying upon *Cernuto,* reversed a grant of a directed verdict in favor of defendant because the plaintiff insurance agency had alleged an agreement by its competitors in the insurance industry, aided by an insurance company, to exclude it from the market.

[4] The situation in the instant case is materially different. The practices plaintiff complains about have been a part of the soft-drink industry for over seventy-five years and were imposed by the licensors, including PepsiCo. *See In re the Coca-Cola Company,* 91 F.T.C. 517 (1978); *In re PepsiCo., Inc.,* 91 F.T.C. 680 (1978). The Act is a direct result of the adverse decisions the soft-drink companies received from the Federal Trade Commission. It may be "special interest legislation," as plaintiff characterizes it, (plaintiff's brief in opposition to the motion to dismiss at p. 15), and there may be good reasons why plaintiff finds the Act objectionable. Nevertheless, Congress did pass it into law and, as defendants correctly assert, the legislation makes lawful what would otherwise be tested by a rule of reason analysis in litigation. We believe it would be totally unreasonable, given the history of the industry, the history of the Act, and the language of the Act itself, to accept plaintiff's contention that the conduct of the defendants is a horizontal conspiracy inspired by the defendant bottlers.

Contrary to plaintiff's position, section 3502 is not applicable here. There are numerous references in the legislative history to this section but its purpose can be accurately summarized by the following passage from the House Committee Report dealing with section 3502:

> In restating the law applicable to vertically imposed territorial restraints in the soft drink industry, the Committee in no way seeks to address or alter existing proscriptions in the antitrust laws governing territorial restraints that are horizontally inspired or imposed. *United States v. Topco Associates, Inc.*, 405 U.S. 596 [92 S.Ct. 1126, 31 L.Ed.2d 515] (1972). The fact that a particular restraint may appear vertical on its face would not preclude a court from closer analysis revealing hidden horizontal restraints. *United States v. Sealy, Inc.*, 388 U.S. 350 [87 S.Ct. 1847, 18 L.Ed.2d 1238] (1967). Nor should a court overlook the fact that territorial restrictions initially vertically imposed by a manufacturer on his franchisees may with the passage of time take on a dominant horizontal character that brings them within the purview of the per se rule. See *United States v. General Motors Corp.*, 384 U.S. 127, 136 [86 S.Ct. 1321, 1325–26, 16 L.Ed.2d 415] (1966).
>
> Section 3 of the bill [section 3502] ensures that actions constituting per se violations of the antitrust laws are not authorized under the guise of enforcing otherwise valid territoral restrictions. It underlines the Committee's intention that the bill not be used to legalize price fixing agreements, horizontal restraints of trade or group boycotts.
>
> At the Subcommittee hearings, at least one witness testified that the language of H.R. 3567 as introduced might legalize certain horizontal boycotts or other per se violations of the antitrust laws. Section 3 addresses this problem and makes certain that the bill will not legalize per se violations of the antitrust laws. Several examples of per se conduct are listed—price fixing agreements, horizontal restraints of trade, and group boycotts. It is the committee's intent that other conduct deemed by the courts to be per se unlawful also not be authorized by this bill.
>
> The term horizontal restraints of trade is intended to include both primary boycotts and secondary boycotts. The courts have traditionally pierced the veil of supposed vertical restraints that were actually horizontal agreements. Section 2 of this bill in no way protects such agreements.

H.R.Rep. No. 1118, 96th Cong., 2d Sess. 6, *reprinted in* 1980 U.S.Code Cong. & Admin.News 2373, 2377–78 (footnotes omitted) (brackets added).

In all of the cases cited in the Report, the restraint was horizontal, and therefore *per se* illegal, even though, at first blush, it appeared that the restraint was being imposed vertically from above. *General Motors Corp.* has already been accurately summarized above in the quotation from *Cernuto*. *Topco* dealt with the validity of exclusive territories conferred upon individual member supermarkets of a buying cooperative. The cooperative, Topco Associates, had no existence apart from its members. Hence, the court found that there was actually a horizontal conspiracy, a *per se* violation of the Sherman Act. Similarly, *Sealy*, cited by the Court in *Topco*, dealt with a corporation which was entirely owned by its licensees who agreed to maintain exclusive territories. Thus, an apparently vertical restraint was really a horizontal one.

Section 3502 does serve an important purpose. For example, it prevents bottlers from urging upon their licensee the adoption of a restraint which the bottlers desire to impose for anti-competitive purposes. In the absence of section 3502, such a restraint would appear to be vertical and hence protected by section 3501. But, as defendants have correctly noted, plaintiff does not allege that Allegheny and Confair agreed to force PepsiCo to grant exclusive territories upon them. Rather, the territories were conferred upon them by PepsiCo. We also note that the plaintiff has not alleged that the other practices were inspired by the bottlers for their protection. It is irrelevant that the bottlers cooperate in enforcing the territories or complain to PepsiCo when the territories have been violated. *See Davis-Watkins, supra.* The complaint alleges nothing more than a classic vertical restraint which is protected by the specific provisions of the Act, and we do not believe that we are required to allow this case to proceed on the facts alleged. *See Satellite Financial Planning Corp. v. First National Bank,* 633 F.Supp. 386 (D.Del.1986).

[5, 6] The only remaining issue is the plaintiff's claim that the defendants have engaged in a group boycott by refusing to deal with resellers who would otherwise sell to other resellers. The effect is to pressure resellers with the goal of excluding resellers from entering the wholesale market for Pepsi-Cola. The short answer to this contention is that the practice is made lawful by the Act. It is a provision, as shown above, which enforces the exclusive territories. Section 3502 does not sanction group boycotts which would "otherwise be unlawful," but, just as plaintiff has failed to allege that the restraints are horizontal rather than vertical, plaintiff has also failed to show that the group boycott was instigated by the bottlers to exclude the resellers from the market.[2]

We will issue an appropriate order.

ORDER

AND NOW, this 28th day of April, 1987, it is ordered that:

1. Defendants' motions to dismiss are granted and plaintiff's complaint is hereby dismissed.
2. The Clerk of Court shall close this file.

UNITED STATES of America, Plaintiff,

v.

Roman TAUER, et al., Defendants.

No. 86-C-805.

United States District Court,
E.D. Wisconsin.

April 28, 1987.

United States commenced action seeking to foreclose several outstanding tax liens placed upon real estate owned by taxpayers. Taxpayers filed cross claim against Wisconsin, seeking to challenge amount of several delinquent tax assessments levied by state. State moved to dismiss cross claim. The District Court, Myron L. Gordon, Senior District Judge, held that taxpayers could not, in United States' action to foreclose tax liens, assert cross claim against Wisconsin as additional party defendant, challenging amounts of several delinquent tax assessments levied by state.

Motion to dismiss granted.

1. States 🔑191(1.24)

Wisconsin's sovereign immunity has not been waived so as to allow cross claim by taxpayers against state in United States' action seeking to foreclose outstanding tax liens on real estate, in light of elaborate procedures for reviewing state tax assessments established elsewhere in Wisconsin statutes. W.S.A. 71.01 et seq., 73.01 et seq., 77.01 et seq., 775.10.

2. States 🔑191(1.24)

Fact that Wisconsin had filed answer to taxpayers' cross claim in United States' action seeking to foreclose outstanding tax liens was insufficient to establish waiver of its sovereign immunity. W.S.A. 775.10.

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[2] Plaintiff argues that defendants have failed to show that this is a trademark licensing agreement protected by the Act. We believe, however, that we can take judicial notice that the agreement at issue in this case is a trademark licensing agreement. *See Coca-Cola Co. v. FTC, supra.*

Senator **Metzenbaum**. Thank you very much, Mr. Gellhorn.

Mr. Leonard, we are happy to hear from you, sir.

Mr. **Leonard**. Thank you, Mr. Chairman. The Community Nutrition Institute is a non-profit consumer-interest organization that concentrates on food policy issues.

Senator **Metzenbaum**. Do you want to bring the mike a little closer to you or speak a little louder?

Mr. **Leonard**. I have spent the last four or five days out in Kansas talking with, I suppose, 200 or 300 people, and I have asked farmers and cattlemen and truck drivers and housewives and students and shopkeepers, aircraft workers, and executives if they thought the legislation that would cause beer prices to be increased is in the public interest or in the consumer interest.

I must say that there is a substantial distrust of anything that Washington does out in Kansas. When I started asking the questions, the temperature was 93 degrees. When I left there yesterday, the temperature was 106 degrees. Although I do not think the questions caused the heat to go up, everybody is drinking a lot more beer.

The beer bill is an effort on the part of the beer industry to extract more profits from the marketplace by restricting competition through exclusive territory licensing. It is nothing particularly new, as I will explain later.

The argument for the bill is novel, however. Proponents argue that the Supreme Court decision in *Continental TV* v. *GTE Sylvania* authorizes exclusive territories within the rule of reason, which apparently means that exclusive territories which promote competition are okay and those that do not are not.

The beer distributors are asking Congress to free them from the rule of reason to legalize a fraudulent scheme to license local monopolies. We live in a service economy today, and in a service economy the Supreme Court has accepted the argument that services may be enhanced by limiting product competition; that is, if it promotes distributional efficiencies which involve the delivery of unique and hard to acquire services.

Every institution is entitled to make a mistake, but even if the Court's ruling is good economics, it could not apply to the services provided by the beer industry, and the reason is simply. The Court's ruling is basically uncertain; that is, it believes that shoddy products might be driven out by competition, but shoddy services should be judged by a different standard. It clearly seeks to distinguish the economics of services from that given by products that do not deliver services.

Now, the economics of beer distribution evolved in a different era and they have not changed. Beer is a beverage today just as it was 100 years ago.

Beer prices can be raised higher than would be the case in a competitive marketplace if supply can be restricted somewhere between production and the point of sale. Beverage producers have known this for a very long time.

Milk producers, for example, have territorial monopolies and fixed prices conferred upon them by Federal marketing orders. That is one of the reasons why milk prices are higher than beer prices or that the increase in milk prices has been faster. For the past 10 years, Federal power has been used to increase milk prices. To ensure this monopoly, Congress even gives milk producers the power to prevent consumers from participating in court decisions to challenge these kinds of price-enhancing schemes, and in some States—New York, for example—they have licensing authority that restricts the number of milk distributors. In New York City this year where the policy was finally reversed, one of the first things that happened was that milk prices dropped 50 cents a gallon. So the barons of beer distribution, like the dairy co-ops, know that profit comes from restricting competition.

Four brewers now control 80 percent of the national beer market, and in some States half the distributors have monopolies in at least two of the four brands. This bill is a scheme to legalize a fraudulent practice. It is a shakedown of beer drinkers and it is wrong, and no amount of rhetoric, well meaning as it may be, can make it right, and I hope the legislation is defeated in committee.

Thank you.

[Prepared statement follows:]

CNI
Community
Nutrition Institute

2001 S Street N.W., Suite 530 • Washington, D. C. 20009 • (202)462-4700

Testimony prepared for delivery by
Rodney E. Leonard, Executive Director
of the Community Nutrition Institute,
before the Senate Antitrust, Monopolies
and Business Rights Subcommittee
Tuesday, August 4, 1987

Mr. Chairman, members of the subcommittee.

Thank you for the invitation to testify on S. 567, the Malt Beverage Interbrand Competition bill, a legislative proposal that is not in the consumer interest. I am the Executive Director of the Community Nutrition Institute, a non-profit consumer interest organization that concentrates on food policy issues. I am an economist by training and a writer and editor by profession.

The beer bill is an attempt by the beer industry to use federal power to extract more profit from the marketplace by authorizing beer barons to restrict competition through exclusive territory licensing of distributors. It is nothing particularly new, as I will explain later.

The argument for the beer bill is novel, however. Proponents of the legislation argue that the Supreme Court decision in Continental TV v. GTE Sylvania authorizes exclusive territories within the "rule of reason." As the Supreme Court defines the term, it means that exclusive territorial arrangements which promote competition are legal and those which restrict competition are illegal.

The beer barons and their distributors are asking Congress to free them from the rule of reason, to legalize a fraudulent scheme to license local monopolies and extract monopoly prices.

We live in a service economy today. And, in a service economy, the Supreme Court has accepted the argument that services may be enhanced by limiting product competition — i.e., if it promotes distributional efficiencies which involve the delivery of unique and hard to acquire services (such as the delivery and maintenance of electronic equiment to perform unique functions). Every institution is entitled to make a mistake. However, even if the Court's ruling is good economics, it could not apply to the services provided by the beer barons.

The reason is simple. Although the Court's ruling is basically uncertain — i.e., shoddy products may be driven out by competition, but shoddy services should be judged by a different standard — it clearly seeks to distinguish the economics of services that give a unique character to products from those that do not.

The economics of beer distribution evolved in a different era, and have not changed. Beer is a beverage today just as it was a hundred years ago. Beer prices prices can be raised higher than would be the case in a competitive marketplace if supply can be restricted somewhere between production and the point of sale.

Beverage producers have known that for a long time. Milk producers, for example, have territorial monopolies (and fixed prices) conferred on them by Federal marketing orders. To insure this monopoly, Congress even prohibits consumers from challenging this price enhancing scheme. Some states have gone even further by using licensing authority to restrict the number of milk distributors, a policy that in New York raises milk prices at least 50 cents a gallon.

The beer barons, like the dairy coops, know the profit in restricting competition. Four brewers now control 80 percent of the national beer market; and, in some states, half the distributors have monopolies in at least two of the four brands.

S. 567 is simply a scheme to legalize a fraudulent practice to shakedown the beer drinkers of America. It is wrong, and no amount of rhetoric, well-meaning as it may be, can make it right. The bill should be defeated in the Committee, and allowed to go no further.

Senator METZENBAUM. Thank you, Mr. Leonard.

Mr. Leonard, I usually ask this question when groups such as yours appear before us. You represent the Consumer Nutrition Institute, which is a non-profit organization.

Mr. LEONARD. Yes, sir.

Senator METZENBAUM. Can you tell us how you are funded?

Mr. LEONARD. We are funded through publications, primarily. We have a newsletter that goes out to about 2,500 people and most of our income comes from that source. We do some training and technical assistance work, also.

Senator METZENBAUM. I am sorry?

Mr. LEONARD. We also do some training and technical assistance on contract.

Senator METZENBAUM. And does any one particular company or organization or group contribute a substantial amount to your funding?

Mr. LEONARD. No, sir.

Senator METZENBAUM. Does any particular segment of industry or any particular segment of society——

Mr. LEONARD. Industry generally contributes very little.

Senator METZENBAUM. Pardon?

Mr. LEONARD. Industry contributes very little to our activities, sir.

Senator METZENBAUM. And would you say that most of your funding comes just from those 2,500 members?

Mr. LEONARD. Yes, sir.

Senator METZENBAUM. Mr. Gellhorn, you say that this is not a bill that provides an exemption from the antitrust laws, but if it looks like a banana and tastes like a banana and slices like a banana, it comes out the same.

Now, as I read this language, I will admit it does not provide, as the McCarran-Ferguson Act does, a specific exemption, but it does say "nothing contained in any antitrust law shall render unlawful the inclusion and enforcement in any written contract * * * of a trademarked malt beverage with any wholesale distributor of provisions granting the wholesale distributor the sole and exclusive right to distribute and to sell such product in any defined geographic area within any State and limiting such exclusive distributor to the distribution and sale * * * of such product when such product is in substantial and effective competition with other malt beverage products within that defined geographic area." I have skipped some of the words, but I think I have covered the essential ones. That sounds to me like an exemption.

Mr. GELLHORN. Well, Senator, as you know, in the process of drafting legislation it may read to the untrained eye in one connection, but, in fact, hold something to the opposite.

I do not know if that is the case here. All I can tell you is that the only effect of this legislation is to make a decision sharper that the Supreme Court first authored in 1977. As you will recall in 1977, they reversed the rule that they had adopted 10 years earlier which had provided that all exclusive territories, all vertical restraints were illegal automatically in every circumstance.

In 1977, the Court said no; we have learned something. We know now that exclusive territories may aid competition, and what we are going to do is to say that from now on, the courts should look at all the facts and determine whether or not the exclusive territory in this circumstance is likely to aid competition or to hinder it. It was called the rule of reason standard.

Courts have done that, and they have tried in the process to develop some ways in making this test workable. They have floundered. They have, as one distinguished academic put it in a recent article, left the law "in disarray."

Indeed, I received in the mail this morning the current issue of the Antitrust Law Journal. Does it have an article seeking to explain the *Sylvania* standard? It is in almost every one.

There is another article on *Sylvania*. In this issue there is a panel entitled: "Making the rule of reason analysis more manageable." The discussion focused solely on vertical restraints. It has become an unmanageable test in the courts, and we spend not weeks, not four months to decide whether or not this is the kind of case in which one ought to apply a rigorous test, but years.

All that S. 567 is designed to do is to try to separate the wheat from the chaff, the bananas, if you wish, from the apples, and identify those cases in which the vertical restraint could be harmful where there is not competition. It is in that context that the traditional costly rule of reason test ought to be applied.

But where there is no threat, where competition is present to protect the consumer interest—in that case, a much more narrow test is appropriate. Ironically, S. 567 is far less restrictive than is the law in 27 States, including your own. But where substantial competition exists, there is no need to spend the time, the money, the public resources on antitrust litigation. And that is all it is.

Senator **METZENBAUM**. Well, if you follow your line of reasoning, would you not have to provide a similar standard in every industry?

Mr. **GELLHORN**. Senator, that is obviously not the situation since we do not have such legislation before us. But if you would introduce it, I would be happy to examine it and probably support it.

Senator **METZENBAUM**. Good, okay.

Mr. **GELLHORN**. But that is not the issue that we have.

Senator **METZENBAUM**. I know it is not. I can make that distinction.

Mr. **GELLHORN**. Sure.

Senator **METZENBAUM**. But having said that, let me ask you, do you believe in the antitrust laws?

Mr. **GELLHORN**. Very much so, and that is why I support legislation that seeks to sharpen and make it more effective and not make it wasteful and a hinderance to American business.

I want to focus American business on that kind of competition which is useful, and focus the antitrust agencies on horizontal restraints which are harmful, not on vertical restraints where there is substantial and effective competition.

Senator **METZENBAUM**. Do you think we should repeal the McCarran-Ferguson Act? That is an exemption to the antitrust laws. If you believe in them, how do you feel about repealing McCarran-Ferguson?

Mr. **GELLHORN**. It is a separate issue; it is the insurance industry. I would be happy to focus on that at some length because I have written on the topic. Since most States already regulate in that area, a broad-based repeal probably would not have any affect or provide a significant advantage to the American consumer.

It might raise costs, but I would have to look at the specific legislation that you propose before I would answer the question.

Senator **Metzenbaum**. Would you care to name some other industries that we ought to extend the application of this legislation to?

Mr. **Gellhorn**. At this point, no, because I do not see any other industry that has provided you with the cost data. I do not see any other industry where we already have two standards before us, with 27 States adopting one standard, one State adopting a very different standard, and the other 22 where the law is very unclear, particularly because of this confusion over the meaning of the rule of reason.

That is a particular circumstance where we have substantial evidence to demonstrate the need for this legislation, but unless you can bring that kind of evidence before us, I would suggest no, that it would not be appropriate yet.

Senator **Metzenbaum**. Mr. Abrams, Mr. Gellhorn makes an argument that we need this legislation because in New York the litigation is going to take 2 to 5 years. In Pennsylvania, it was dismissed in four months.

Would you care to comment on his observations? He makes some other arguments as well, of course.

Mr. **Abrams**. Well, if we eliminate all the antitrust laws, significant amounts of the antitrust laws, we will not have any rules; we will not have any lawsuits. So there will not be any litigation and it will not be time consuming.

My views are clearly stated that this is very important in terms of ensuring that there is free and open competition among distributors, intraband and interbrand. Moving in this direction, I think, again, as Mr. Gellhorn indicated, based upon the data that we have, has clearly been demonstrated to be against the consumer interest because of the tremendous increase in the price of beer over the period that these territories have been in effect in New York.

Senator **Metzenbaum**. Senator Thurmond.

Senator **Thurmond**. Thank you.

Mr. Gellhorn, what are the competitive benefits that accrue to the beer industry from the use of exclusive territories?

Mr. **Gellhorn**. They are hard to demonstrate, I suppose, all in advance, but I think we can identify several. First, of course, is the cost of litigation. Here, you are talking about an industry with some very small wholesalers, and the cost of this litigation, for example, in New York is very burdensome to them. Mr. Abrams make the valid point that it may be the price of business, but not the price of business because the law is unclear.

Second, by giving a wholesaler a specified area in which to operate, the manufacturer—in this case, the brewer—says I am going to get more out of it than it will cost me. Now, what could it cost me?

It could, by giving him an exclusive territory, provide the opportunity for the wholesaler to raise price, but that is not going to be present when there is substantial and effective competition.

Beer, for example, is an industry in which there is intense price competition. Why? Well, because take a look at what has happened in the market over the last 20 years. Who were the leading sellers of beer 20 years ago? Schlitz, Pabst, companies that are virtually gone today. Who are the leaders today? Anheuser-Busch, Miller, and Stroh's. Miller and Stroh's were barely heard of 10 or 15 years ago.

Where you see rapid market changes, you are seeing intense price competition. So the benefits they are likely to get is the wholesaler will give better service, will clear out old, stale beer, if that is what the problem is. The manufacturer is also trying to get the wholesaler to invest in serving his retailers, to the advantage of the manufacturer, as against other brewers.

It is, in other words, to intensify competition. Those are the very arguments the Supreme Court adopted in 1977 when they approved the rule of reason in *Sylvania*. The difficulty with what the Court did is its test has not worked completely, and all we are trying here is to suggest to Congress its historic role of guiding the Court and providing it additional insight into how the laws ought to be applied.

Senator THURMOND. Now, what benefits, if any, are enjoyed by the consumer as a result of exclusive territories?

Mr. GELLHORN. The benefit here would be better service. It is more likely, for example, that the wholesaler will serve the rural areas, the smaller firm out of the way, because if you exclude exclusive territories, the primary focus is going to be on the high-volume outlet, not on the low-volume outlet, so you get broader distribution of the product. You will get an opportunity for the wholesaler to focus his or her energy on how to serve the consumers in that area.

Third, you will get what Professor Tollison has demonstrated in his very able study, and that is, apparently, the possibility of a price decrease, that price decrease coming because the law, being so confused, is so costly to apply.

He is more cautious, I suppose, than I am on it because he is saying that there is statistical significance, but there may be other reasons.

Senator THURMOND. How should substantial and effective competition be interpreted? How did the Court interpret this language in the *Pepsico* case, to which you referred in your written statement?

Mr. GELLHORN. The Court in *Pepsico* heard economic evidence on whether competition in the soft drink market was substantial and effective. The Court heard evidence from the wholesalers and bottlers in the area. The Court heard evidence from marketing experts, and what it looked to was a variety of factors very similar to what the Court looks at under the Clayton and the Sherman Act in determining whether or not, as one of the elements in these cases, there is competition present.

It looked to market shares, it looked to price competition, it looked to changing market shares. It looked to the number of people who have entered the industry and the number who have left.

For example, if it were the beer industry, we could identify that there are 30 new brewers in the market today who were not there 15 years ago, who were not there 5 years ago.

Senator **Thurmond**. Thank you very much. That is all, Mr. Chairman.

Senator **Metzenbaum**. Thank you, Senator Thurmond.

Mr. Abrams, would you tell us a little bit about that case in Pennsylvania that was dismissed and why it was dismissed?

Mr. **Abrams**. I will ask Mr. Constantine to comment on that.

Senator **Metzenbaum**. Mr. Constantine.

Mr. **Constantine**. Senator, that case was dismissed—and I think it raises an important point—that case was dismissed because the court was confusing the rule which is applicable to vertical restraints and the rule applicable to horizontal restraints.

The allegation of the attorney general in Pennsylvania was of a horizontal conspiracy, of a boycott, and the court, with no proof before it at all, dismissed the case. This has happened before.

In Texas, an action by the attorney general of Texas under the Texas Merger Act was dismissed as being preempted by the Soft Drink Interbrand Competition Act. What clearly results from enacting a standard like that enacted in soft drinks and in the malt beverage bill is to create confusion in the courts.

I would predict that when this case goes up to the circuit, you are not going to do away with litigation, but you are just going to have a reversal and a remand for a proper determination under this nebulous standard.

Senator **Metzenbaum**. Did they assert that the soda bill was a defense to your action in Pennsylvania?

Mr. **Constantine**. They asserted in Pennsylvania that the 1980 Soft Drink Interbrand Competition Act was an affirmative defense to the allegations made by Attorney General Zimmerman in Pennsylvania, and those allegations, again, were of a horizontal conspiracy.

The Soft Drink Act was not supposed to touch horizontal conduct. The court confused that. The court dismissed that because of the complicated and unknown standard which was in that Act and which would be foisted on this industry by this Act.

Senator **Metzenbaum**. What were some of the actions that the soft drink bottlers were doing in Pennsylvania?

Mr. **Constantine**. They were conspiring to prevent resale to other parties. The boycott was eliminating the resale of soft drink syrup to other sellers in the marketplace, but it was not a vertical restraint; it was a horizontal conspiracy among competitors at the same level of the industry.

Senator **Metzenbaum**. Well, spell out for me, if you can and if you know, more specifically what you mean when you say they were conspiring on a horizontal basis. Put it in language that the average beer drinker would understand.

Mr. **Constantine**. Well, a horizontal conspiracy——

Senator **Metzenbaum**. No, I am not really asking you what a horizontal conspiracy is. I understand that. I am asking you what were they doing. Were Company A and Company B agreeing not to sell to Company C, or were they agreeing to limit the price?

Mr. **Constantine**. Company A and Company B, exactly, were conspiring not to resell to Company C, who were competitors of Company A and Company B. So it was conspiracy to eliminate horizontal competition.

The Soft Drink Act was meant to sanitize certain conduct of a vertical nature and it had the unintended effect in that case of sanitizing a per se unlawful horizontal conspiracy. As I have said, in other cases around the country the Soft Drink Act has been interpreted to immunize conduct that was never intended, and that is because it is an unknown standard, it is a nebulous concept, and it is subject to misinterpretation by the courts.

Rather than lead to less litigation, it leads to more appellate litigation. In the Texas case which I cited, the Texas court dismissed a merger action saying it was preempted by the Soft Drink Act. That decision went all the way up through the Texas courts and then was reversed. You did not have less litigation; you had more litigation more costly to both parties.

Senator **Metzenbaum**. Well, please understand, Mr. Constantine, I am less concerned about the amount of litigation than I am about the cost to the consumer and its impact upon the consumer, and I am trying to get that aspect out of you because, yes, I want to eliminate inappropriate litigation, and I think many of us do, but I think it is a secondary consideration to the question of impact upon prices, impact upon availability.

I gather that is what you are saying to me did occur in Pennsylvania, and that the court threw the case out, notwithstanding that kind of factual situation, thereby permitting the soft drink bottlers to continue the same kind of activity.

Mr. **Constantine**. Precisely.

Mr. **Abrams**. Senator, on that point, because reference has been made to what we submitted to you in this committee as a survey to indicate precisely the issue that you are talking about, it was not a survey; it was not done by a vested interest of the industry that would be affected by the legislation, the latest data that Mr. Gellhorn is submitting to this committee.

The New York City Department of Consumer Affairs for decades has gone weekly to the marketplace to determine the cost of goods in the market basket, and two of those elements have been, historically, carbonated beverage, soda, and beer.

Independent of our ever getting involved in this case, we did not make a request of a survey. We just went to resource data that historically is there, and we have traced over a 5½-year period from the time that exclusive territories went into effect for the distribution of beer to the present moment and we have seen a 40-percent increase—a 39.5 percent increase to the consumer, to the purchaser of that six-pack in the city of New York in supermarkets.

In 1982, beer was $2.66 a six-pack and the latest data that we had from the Department of Consumer Affairs was that it rose more than a dollar in that intervening period of time to $3.71.

So that is a concrete example of what happens when you impose these kinds of exclusive territories to a consumer, a purchaser and user of that product.

Senator **Metzenbaum**. Thank you.

At this point, the Chair will insert in the record a letter from the Consumers Union, which says:

> This legislation would tend to reduce interbrand competition, which is important in keeping down the prices consumers pay for beer and other malt beverages. We do not believe that similar protection to the soft drink industry has resulted in preserving the small competitor and we not believe that it will have the result in beer distribution. Rather, consumer prices will tend to rise higher than they would otherwise and yet more industries will ask for similar special treatment.

[The following was received for the record:]

Consumers Union
Publisher of Consumer Reports

August 4, 1987

Honorable Howard Metzenbaum
Chairman, Subcommittee on Antitrust,
Monopolies and Business Rights
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Consumers Union remains firmly opposed to S.567, the so-called "Beer Bill," which would grant special treatment to territorial allocation practices in malt beverage distribution. This legislation would tend to reduce intrabrand competition, which is important in keeping down the prices that consumers pay for beer and other malt beverages.

We do not believe that similar protection to the soft drink industry has resulted in preserving the small competitor, and we do not believe that it will have the result in beer distribution. Rather, consumer prices will tend to rise higher than they would otherwise, and yet more industries will ask for similar special treatment.

Thus, we urge the Subcommittee to vote "NO" on S.567.

Sincerely,

Mark Silbergeld

Mark Silbergeld,
Director,
Washington Office

Washington Office
Suite 520, 2001 S Street, Northwest · Washington, D.C. 20009 · (202) 462-6262

Senator **Metzenbaum**. I might say that when we passed the bottlers bill, the Senator from Ohio predicted on the floor of the Senate that this bill would not be long in coming forth. It did not take long; in the next session, we had it.

I also will introduce a letter in opposition to the bill from the Department of Consumer Affairs of the City of New York; a letter from the American Bar Association, the Antitrust Section; a letter from the Consumer Federation of America; a letter from Public Citizen; and a letter from Public Interest Research Group, all in opposition to the legislation.

[The following material was received for the record:]

City of New York
Department of Consumer Affairs

80 Lafayette Street
New York, N.Y. 10013

Angelo J. Aponte
Commissioner

August 3, 1987

Senator Howard Metzenbaum
Senate Judiciary Committee
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

As you are aware, the New York City Department of Consumer Affairs has long been on record as opposing any version of the Malt Beverage Interbrand Competition Act, at either the State or Federal level. Since this legislation has once again resurfaced, this time as S.567, I once again would like to state our opposition to any legislation which would exempt the beer industry from anti-trust regulation.

New York's experience with territorial monopolies provides the perfect context for analyzing the potential effects of S.567. While the proponents of this legislation--specifically the beer industry--insist that exclusive distributorship will improve the quality of beer and not raise prices, this has not been the case in New York. At one time, New York had one of he most competitive beer markets in the country, resulting in consistently low beer prices. Early in 1983, Annheuser Busch and Miller began establishing territorial monopolies in the State. The territorial monopolies went into full effect in September of that year, coinciding with the the implementation of the New York State Returnable Beverage Container Act (the "Bottle Bill"). As I have stated before, this coincidence conveniently obscured the reasons for the subsequent dramatic price increases for beer.

The Department of Consumer Affairs monitored beer and soda prices from July 18 through September 23rd of 1983. During this time period, the average cost of a six-pack of Budweiser rose 31.6 percent or 81 cents, from $2.56 to $3.37. The price of a six-pack of Coke rose only 10.6% or 22 cents, from $2.08 to $2.30. According to the Department's monthly market basket survey, beer prices have continued to rise, while the prices of soda rose briefly in 1985-early 1986, and have declined to levels frequently lower than the prices recorded following the implementation of the Bottle Law. To illustrate this point, I have enclosed a list of beer and soda prices from 1984 to the present. (The Department surveys Budweiser or Miller, and Coke.

The impact of S.567 for New York City, however, extends beyond higher beer prices. There are 150 secondary beverage distributors or discount centers in New York City that shop state-wide or out-of-state for lower priced beer which is then sold to neighborhood grocery or liquor stores and bodegas. The smaller retailers have neither the capital nor the shelf space for large stocks of single-brand or expensive beer; they depend on the secondary distributors to sell mixed-brand truckloads of discount beer, and to remain open in off-hours so that retailers can restock frequently. Moreover, the discount centers employ an estimated 2,000 workers, 50-60 percent of whom are Black or Hispanic. Minority entrepenours own 30 percent of the centers, primarily in economically depressed neighborhoods. These centers earn almost $500 million a year. Not only the centers but the small retailers may be forced out of the market if beer distributors are exempted from anti-trust laws and beer prices continue to rise. The loss to New York City would be tremendous.

I should not have to reiterate that the quality of beer will not be enhanced by this legislation, but that argument is again being employed in support of S.567. There is simply no problem with stale beer from out-of-state shipments. Retailers and secondary distributors have a vested interest in stocking quality products. If stale beer were a problem, brewers need only stamp visible freshness dates on bottle and cans.

If S.567 passes, the state will not gain control over alcohol distribution, as has been claimed by proponents of territorial monopolies. Rather real control will rest with the major breweries and a handful of wholesalers in each state. On behalf of the Department of Consumer Affairs of New York City, I support your fight to defeat S.567. It is time to put to rest once and for all this industry effort to gain an unwarranted exemption from existing anti-trust laws.

Sincerely,

Angelo J Aponte

Angelo J. Aponte
Commissioner

AJA/MG/pf

Enclosure

	BEER	SODA
1984		
Jan. 3 - 13	3.42	2.29
Jan. 16 - 27	3.51	2.26
Jan. 30 - Feb. 10	3.42	2.19
Feb. 14 -24	3.46	2.17
Feb. 27 - Mar. 9	3.49	2.24
Mar. 12 - 23	3.26	2.24
Mar. 26 - Apr. 20	3.39	2.23
Apr. 23 - May 18	3.41	2.27
May 21 - June 15	3.44	2.20
June 11 - July 13	3.44	2.15
July 16 - Aug. 10	3.47	2.13
Aug. 13 - Sept. 7	3.39	2.17
Sept. 10 - Oct. 5	3.52	2.34
Oct. 8 - Nov. 2	3.56	2.35
Nov. 5 - 30	3.54	2.39
Dec. 3 - 28	3.49	2.30
1985		
January	3.55	2.38
February	3.60	2.45
March	3.57	2.36
April	3.61	2.44
May	3.62	2.43
June	3.61	2.43
July	3.58	2.39
August	3.54	2.37
September	3.50	2.30
October	3.58	2.46
November	3.56	2.41
December	3.49	2.41
1986		
January	3.58	2.49
February	3.66	2.42
March	3.77	2.39
April	3.74	2.36
May	3.76	2.29
June	3.79	2.32
July	3.79	2.25
August	3.77	2.22
September	3.71	2.29
October	3.69	2.32
November	3.69	2.34
December	3.66	2.37
1987		
January	3.60	2.37
February	3.67	2.36
March	3.71	2.29
April	3.71	2.24
May	3.53	2.21
June	3.71	2.10

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August 3, 1987

Senator Howard Metzenbaum
Chairman, Subcommittee on Antitrust,
Monopolies and Business Rights
Senate Judiciary Committee
224 SROB
Washington, D.C. 20510-6275

Re: S.567 -- Malt Beverage Interbrand Competition Act

Dear Senator Metzenbaum:

On August 4, 1987, the Senate Judiciary Subcommittee on Antitrust, Monopolies and Business Rights is scheduled to hold a hearing on S.567 -- the Malt Beverage Interbrand Competition Act. The American Bar Association opposes the enactment of S.567 since it would create an unnecessary and potentially anticompetitive special exception to the antitrust laws by authorizing brewers to enter into exclusive territorial arrangements with distributors for the sale of their brands.

The stated purpose of S.567 is "[to] clarify the circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws." The bill provides that nothing contained in any federal antitrust law shall render unlawful exclusive territorial agreements in any written contract between a wholesale distributor and any brewer, importer, trademark owner, or trademark licensee of a trademarked malt beverage, so long as the malt beverages covered by such agreements are in "substantial and effective competition with other malt beverage products within [a] defined geographic area." The bill further provides that nothing in the bill shall be construed as legalizing enforcement of exclusive territorial arrangements by means of unlawful price-fixing agreements, horizontal restraints of trade, or group boycotts.

The ABA's primary concern with legislation such as S.567 is that it creates an unwarranted exception to the antitrust standard applied to most other American businesses. The antitrust laws were created by Congress nearly a century ago to embody a fundamental national policy of free market competition. As the Supreme Court stated in Northern Pacific Railway v. United States, 356 U.S. 1, 4 (1958), the "Sherman Act was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress . . ." The antitrust laws have proved to be flexible and adaptable to a wide variety of factual circumstances in a great number of industries. The January 1979 Report of the President's National Commission for the Review of Antitrust Laws and Procedures concluded that Congress' reliance upon the antitrust laws to protect and promote competition has been abundantly justified, and that exemptions from the antitrust laws should be granted only "where there is compelling evidence of the unworkability of competition or a clearly paramount social purpose." Id. at 177. We do not believe that such "compelling evidence" has been or could be shown with respect to the malt beverage industry.

Congress, having created a sound and effective body of law, should exercise great restraint in interfering with the working of that law, and should place a very heavy burden of proof on proponents of special exemption legislation to show that existing procedures will involve extraordinary hardship and cause extraordinary injury to the public. The malt beverage industry has not demonstrated any compelling reason why this industry should be exempted from one of the basic antitrust rules which apply to virtually every other industry in the United States.

The legality of exclusive territorial arrangements is at present determined under Section 1 of the Sherman Act, 15 U.S.C. § 1, which outlaws "[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations . . . ." In applying this section of the Act to territorial arrangements between suppliers and their distributors, courts use the "rule of reason" to determine whether, under all the circumstances, the particular arrangement is an unreasonable restraint of trade. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). In adopting this standard, the Supreme Court correctly recognized the fact that vertical restraints, while not necessarily anticompetitive, may have anticompetitive effect and may therefore require challenge under Section 1 in certain circumstances.

Brewers at present can and do enter into exclusive territorial arrangements with their wholesalers, and cases decided since GTE Sylvania have recognized the economic benefits that vertical territorial arrangements may provide. Since the antitrust laws currently outlaw only those arrangements that are anticompetitive, the only exclusive territorial arrangements that could be legalized by the bill are those which would be predominantly and demonstrably anticompetitive. Furthermore, so-called legislative "legitimization" of exclusive territorial arrangements in the malt beverage industry could be construed to imply that such arrangements are less legitimate in industries not covered by this legislation.

The antitrust enforcement agencies should retain the option of challenging exclusive territories where they facilitate collusion or otherwise injure competition, whether in the beer industry or any other industry. The present legal structure provides this flexibility, but the proposed legislation would not. Due to differences in language between Section 1 of the Sherman Act and the malt beverage bill, a court could find certain exclusive territorial arrangements lawful under the bill where it would otherwise conclude that they unreasonably restrained competition under the rule of reason. The bill provides that exclusive territorial arrangements would be deemed lawful if the product was in "substantial and effective competition" with other malt beverages within a defined geographic area.[1] If the proponents of an exclusive territorial restriction could show the existence of such competition, it appears that the bill would countenance, without further inquiry, the total elimination of intrabrand competition, an outcome not sanctioned by the Supreme Court in GTE Sylvania.

We are aware that Congress previously passed the Soft Drink Interbrand Competition Act, 15 U.S.C. §§ 3501-03, after which the malt beverage bill is modelled. The ABA opposed that bill and strongly urges that creation of such ad hoc antitrust exemptions must be halted. Piecemeal changes in antitrust standards of general applicability are the least desirable way to effect changes in the law. To the extent that genuine clarification of the antitrust laws governing exclusive territories might be needed, such clarification should be made on a general basis through judicial interpretation of existing antitrust laws.

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[1] Unfortunately, the term "substantial and effective competition" is not defined in the bill, and its meaning is unclear. Unclear also is which party would have the burden of establishing the presence or lack of such competition, how it would be measured, or how much of it would be necessary to satisfy the requirements of the bill. It should be noted that this vague new standard would be likely to engender more litigation than the malt beverage legislation itself is supposedly designed to prevent.

Enactment of further special-interest antitrust legislation would cast doubt on the universal applicability of the antitrust laws to the unregulated sectors of the economy and encourage other industries to seek similar legislation. Continued erosion of basic antitrust standards in favor of special interest groups will significantly undermine antitrust law and policy enforcement by both public agencies and aggrieved private parties.

In sum, the present case-by-case approach to exclusive territorial arrangements, which requires a balancing of all the effects, both pro- and anticompetitive, of a particular territorial scheme, eliminates only those arrangements which unreasonably restrict retailers' ability to deal in malt beverages. The law and its current interpretation are quite clear. Even if the law were not clear, the enactment of piecemeal, industry-by-industry exemption legislation is the least desirable method of clarification. Necessary changes should be made on a general basis through judicial interpretation or carefully considered congressional action. The enactment of the Malt Beverage Interbrand Competition Act would be a significant step towards creation of a patchwork of differing antitrust standards and would undermine the utility and general applicability of the antitrust laws. For these reasons, the ABA opposes the enactment of S.567.

Sincerely,

Mark Crane

Mark Crane
Chairman, Section of
Antitrust Law

CFA Consumer Federation of America

August 3, 1987

The Honorable Howard Metzenbaum
Senate Judiciary Committee
Unites States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

The Consumer Federation of America wishes to voice its strong opposition to S. 567, the Malt Beverage Interbrand Competition Act, and to commend you for lending the opposition to this special interest, anti-consumer legislation.

There is ample evidence that this bill would substantially increase beer prices. It would also continue a disturbing trend in which individual industries seek antitrust exemptions from Congress.

Beer wholesalers do not need the antitrust relief this bill would provide, and we urge other members of the Judiciary Committee to join you in rejecting it.

Sincerely,

Stephen Brobeck
Executive Director

SB:ts

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

PUBLIC CITIZEN

Buyers Up ☐ Congress Watch ☐ Critical Mass ☐ Health Research Group ☐ Litigation Group ☐ Tax Group

Dear Senator Metzenbaum: July 23, 1987

I am writing to urge you to oppose the Malt Beverage Interbrand Competition Act (S.567), more aptly described as an "Anticompetition Act."

The effect of this unfortunate bill, if enacted, would be to needlessly raise beer prices and grant an undeserved exemption from our nation's antitrust laws for beer distributors with territorial monopolies.

Because this bill is a blatant piece of special-interest legislation with no redeeming features, it has been tacked onto totally unrelated legislation in the past, and we ask your continued vigilance in defeating such efforts in the future.

Under the proposed act, brewers would set up territorial monopolies for distributors free of any oversight under antitrust laws. Those in the area who want to buy a particular brand of beer, including grocery stores, bars, or restaurants, would be able to do so only from one distributor. As a result, consumers would have to choose between paying the price for beer set by that distributor or not buying the beer at all.

The anticompetitive effect of the beer bill would be increased by the fact that a firm with a territorial monopoly over the distribution of one brand of beer often holds a territorial monopoly over the distribution of one or more other brands of beer. The result would be the reduction or elimination of price competition among different brands of beer as well as within a single brand.

The arguments on behalf of the bill are disingenuous at best. While it has been suggested that the existing law must be "clarified" regarding exclusive distributorships, the current balancing test, in place since 1918, is quite clear: benefits are to be weighed against anticompetitive effects. The bill's substitute "substantial and effective competition" test is bound to confuse the law and waste courts' time with exercises in interpretation.

Similarly, the suggestion that an exemption from antitrust laws is required to ensure beer's freshness can hardly be made with a straight face. With a shelf life of 75 to 120 days, beer lasts considerably longer than most perishables, such as fruits, vegetables, dairy products and baked goods. Consumers are well

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served by the competition in all of these items, as the market whose goods are not fresh soon loses its customers. If beer brewers and distributors are genuinely concerned about ensuring freshness, they can easily implement an open-dating system such as those used for truly perishable products.

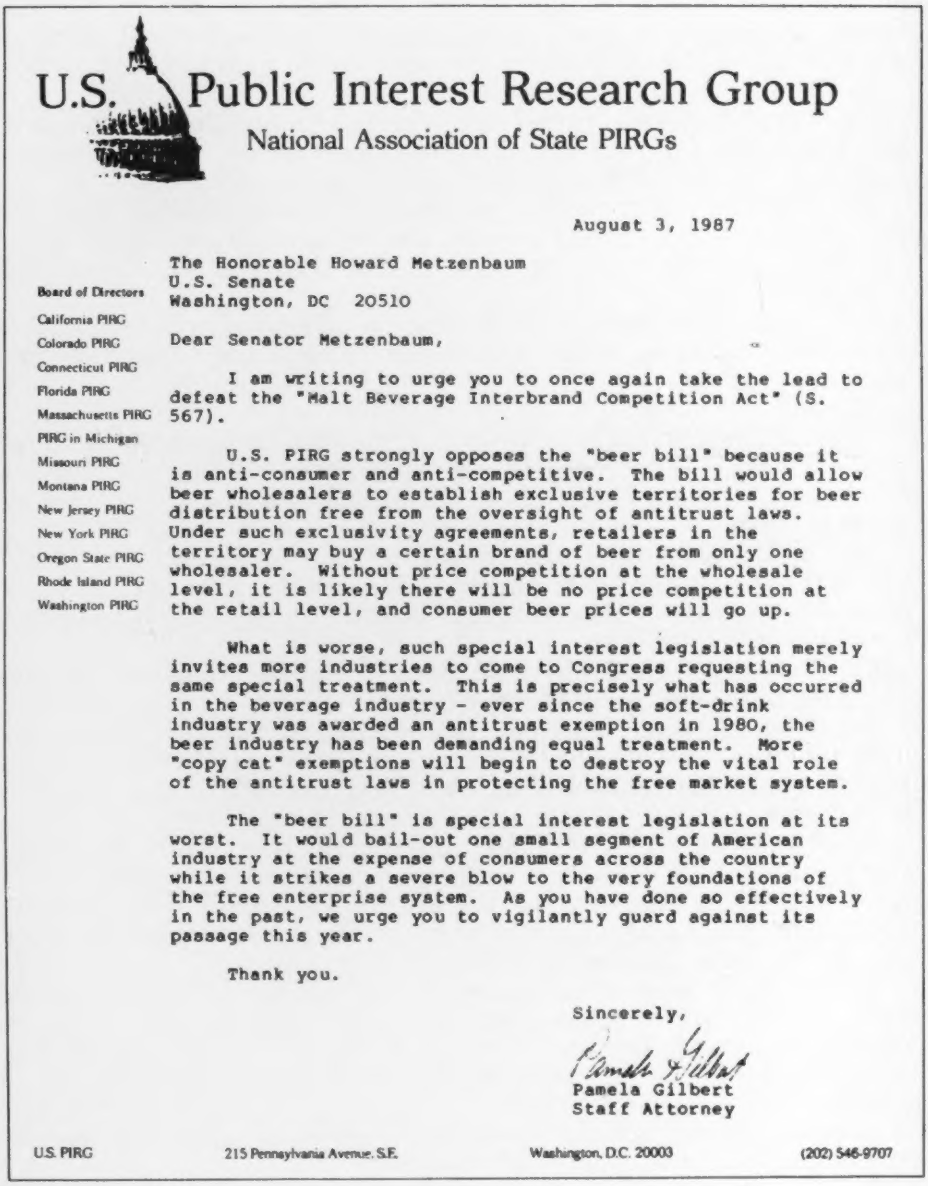
In short, the proposed beer bill would needlessly harm consumers and bestow an undeserved gift upon a single industry, in violation of the long-established public policy of this land. We thank you for your longstanding commitment to defeat such legislation, and we urge your continued support.

Thank you for consideration of our views.

Sincerely,

Eric Hard

Eric Hard
Staff Attorney



U.S. Public Interest Research Group
National Association of State PIRGs

August 3, 1987

The Honorable Howard Metzenbaum
U.S. Senate
Washington, DC 20510

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Dear Senator Metzenbaum,

I am writing to urge you to once again take the lead to defeat the "Malt Beverage Interbrand Competition Act" (S. 567).

U.S. PIRG strongly opposes the "beer bill" because it is anti-consumer and anti-competitive. The bill would allow beer wholesalers to establish exclusive territories for beer distribution free from the oversight of antitrust laws. Under such exclusivity agreements, retailers in the territory may buy a certain brand of beer from only one wholesaler. Without price competition at the wholesale level, it is likely there will be no price competition at the retail level, and consumer beer prices will go up.

What is worse, such special interest legislation merely invites more industries to come to Congress requesting the same special treatment. This is precisely what has occurred in the beverage industry - ever since the soft-drink industry was awarded an antitrust exemption in 1980, the beer industry has been demanding equal treatment. More "copy cat" exemptions will begin to destroy the vital role of the antitrust laws in protecting the free market system.

The "beer bill" is special interest legislation at its worst. It would bail-out one small segment of American industry at the expense of consumers across the country while it strikes a severe blow to the very foundations of the free enterprise system. As you have done so effectively in the past, we urge you to vigilantly guard against its passage this year.

Thank you.

Sincerely,

Pamela Gilbert

Pamela Gilbert
Staff Attorney

U.S. PIRG 215 Pennsylvania Avenue, S.E. Washington, D.C. 20003 (202) 546-9707

Senator Metzenbaum. The Chair will now leave to go to a vote on the floor of the Senate. I will be unable to return. Senator DeConcini has been kind enough to indicate that he will continue the hearings until all of the witnesses may be heard this afternoon.

Thank you, Senator DeConcini.

Senator DeConcini [presiding]. Mr. Chairman, thank you again, and thank you for your time on this important legislation. I appreciate it very much. I do have a couple of quick questions.

Mr. Abrams, we welcome you here. Knowing of your organization and the size of the office and the national organization which you head, we think it is very important that you would take the time to be here.

Is it safe to say, Mr. Abrams, that your testimony is identical or 90 percent the same as Mr. Constantine's testimony was, because I have not read yours, but I did read Mr. Constantine's?

Mr. Abrams. Yes.

Senator DeConcini. It is, because the question I am going to ask you was going to be posed to Mr. Constantine. You state that the competitors will be deprived of "the fundamental right to seek redress in court."

Again, Mr. Abrams, I turn your attention to Section 3 of S. 567, which clearly states that otherwise anti-competitive activities can clearly be redressed. How can your statement have merit under the language of Section 3?

Mr. Abrams. Well, I will supplement what Mr. Constantine says. I will let him take the first crack at it.

Mr. Constantine. Senator, by creating a standard where you overrule the current rule of reason analysis specified by the Supreme Court in the *Sylvania* case, you pre-ordain the result of these cases.

What the Supreme Court said in *Sylvania* was that to determine the legality of an exclusive territory or any non-price vertical restraint of trade, you weighed the effects. On one side of the scale, you weighed the intrabrand effects. On the other side of the scale, you weighed the interbrand effects.

What you do in this legislation is you take away one side of the scale, and by taking away one side of the scale, Senator, you preordain the result. The result of this is to prevent the courts from doing the type of economic analysis which they deem to be appropriate.

Senator DeConcini. You do not take away one side. You insert a rule, right, that the court must follow?

Mr. Constantine. Yes. You insert——

Senator DeConcini. The side is still there. It may be, in your opinion, weaker, but the side is still there. You can still get redress, can you not?

Mr. Constantine. Yes. What you get, Senator, is a stacked deck which says that everything that we considered relevant on one side of the scale is taken off the scale.

Senator DeConcini. Well, you stand by your statement that the fundamental right of redress is no longer there?

Mr. Constantine. Well, I think that is entirely true, Senator. Let me tell you how that would work in the case that is sub judice in New York now. You have a court that is sitting under the current rule of reason analysis. They would weigh the anti-competitive intra-brand effects on one side of the scale and the pro-competitive or anti-competitive interbrand effects on the other side of the scale.

What you have done is you have taken away the analysis on one side and you pre-ordain the result. In fact, this proposed legislation at this point is merely an attempt to do away with the litigation which Attorney General Abrams filed last year.

Senator DeConcini. Well, I would like the record to read here at this point Section 3, and I would like to read it because I have a firm disagreement that redress is not fundamentally wiped out because it says, and I quote, "Nothing in this Act shall be construed to legalize the enforcement of provisions described in section 2 of this Act in any written contract described in that section by means of price-fixing agreements, horizontal restraints of trade, or group boycotts, if such agreement, restraints or boycotts would otherwise be unlawful." It seems to me that redress is still there.

Mr. Abrams, let me ask you this question. Am I correct that the New York survey that I understand you discussed while I was not here was a retail beer price survey, and that based on that retail beer price survey data, you have drawn conclusions about wholesale prices?

Mr. Abrams. Senator, first of all, yes. The data that was compiled, again, not by an industry organization, not in terms of a request to try to shore up or justify a specific piece of legislation that is pending before Congress, but as part and parcel of an overall bread basket analysis that is going on for many decades by a governmental agency—obviously, there is a relationship between wholesale price and retail price.

What this survey clearly showed was a price of beer before there was the creation of exclusive territories tracked over a 5½-year period, and demonstrated that during that period of time when you had the elimination of transshipment and vigorous competition, intra-brand competition—we are talking about a product that is rather unique in the marketplace where there is high brand loyalty because of the hundreds of millions of dollars of advertising expenditure that the beer companies produce to generate loyalty.

You find this precipitous increase, and you can track it week after week over a 5½-year period. I think there is an inescapable conclusion.

Senator DeConcini. Mr. Abrams, did you, in fact, analyze the wholesale part of it and the competition and the prices? Did you zero in on that? Did that study do anything about the wholesale prices, or was it solely what relation flows from the fact that retailers have to buy from wholesalers?

Mr. Abrams. Again, Senator, what we did was show what the retail price of beer was week by week over a 5½-year period during the time that there was the imposition for the first time of exclusive territories.

Senator DeConcini. Based on retail prices?

Mr. Abrams. Correct.

Senator DeConcini. Okay. Now, Mr. Constantine, just onc thing I would like to make clear. I think you said that this legislation was brought to change or circumvent a case that Mr. Abrams and your office has brought a year ago.

This legislation has been around for years. So I want you to know as the author of this that I had no intent, nor do I today, because I introduced it before you even brought your original case. I just want the record——

Mr. CONSTANTINE. Senator, I recognize that, and I did testify before the full committee in 1985 before we brought the lawsuit.

Senator DECONCINI. Right.

Mr. CONSTANTINE. What I was saying is the only practical effect of the legislation at this point is to knock out a pending lawsuit and to prevent a United States district court from entering into a full rule of reason analysis in this case and once and for all determining whether these restraints are pro-competitive or anti-competitive. This is an attempt to prevent the court from fulfilling its judicial function.

Senator DECONCINI. You are not, for the record, saying that that is what this law was introduced for?

Mr. CONSTANTINE. Well, it has evolved into that effect, Mr. DeConcini.

Senator DECONCINI. You are saying that that is why I introduced it, then?

Mr. CONSTANTINE. No, I am not, Senator.

Senator DECONCINI. You are not saying that?

Mr. CONSTANTINE. No, I am not, sir.

Senator DECONCINI. Thank you, sir.

Mr. CONSTANTINE. Thank you.

Senator DECONCINI. Mr. Leonard, you said you did a survey out in Kansas.

Mr. LEONARD. Yes, sir.

Senator DECONCINI. You talked to people out there. What was the question you actually asked them? Would you read that question again?

Mr. LEONARD. What I said was that I was coming back to testify at this hearing and that the hearing dealt with a piece of legislation that would set up a restrictive licensing arrangement that would have the effect of increasing beer prices. Did they support it or oppose it?

Senator DECONCINI. Is that an objective question, do you think? [Laughter.]

Mr. LEONARD. No, but it was a very hot day.

Senator DECONCINI. And did you give them any information before you asked that question, such as did you know, Mr. Smith or Ms. Smith, that I am asking a question and that Kansas already has exclusive territory legislation applying? Did you lay any ground work so they knew what they were talking about?

Mr. LEONARD. No, sir.

Senator DECONCINI. Okay. Now, there have been several studies, Mr. Leonard, of the effect of such legislation on beer prices. These studies, done by respected economists, show that beer prices have stayed the same or have dropped in areas with mandatory exclusive territories.

How do you explain these findings in light of your statement that this bill is just a way to raise beer prices by restricting supply? What is your support for such a statement? Do you have some studies to back that up?

Mr. LEONARD. When you look at the effect over a long period of time of restrictive territorial arrangements such as in New York where the State has restricted licensing of milk distribution at the wholesale level for some 50 years almost, the long-term effect of that has been to increase milk prices. It has been to reduce the quality of retail services, to restrict the quality of distributional service and to restrict the quality of retail services.

It has had the effect of increasing milk prices. The test of that is when a court case finally forced the State to back off—it was a Federal district court case to allow a new distributor to come into the New York City market—the immediate effect was to reduce retail prices.

As far as consumers are concerned, the question of distributional arrangements, distributor prices, wholesale prices is really irrelevant so long as the effect of that arrangement is to increase the cost to consumers. That is all they are concerned about.

Senator DECONCINI. Sure, I agree. That is what consumers are concerned about, and what bothers me is you are indicating that there is less competition. If there is less competition, then this legislation does not apply, and I think that that distinction perhaps has missed some of the witnesses here, but time forbids me to go further.

Mr. Gellhorn, since this legislation is similar to the Soft Drink Act of 1980, the effects of that legislation on the particular industry would be very helpful. Briefly, what have been the effects of that legislation on the amount of litigation in that industry, if you know, and is it safe to compare these two industries?

Mr. GELLHORN. Well, there are substantial distinctions, of course, between the two industries. But in terms of this legislation, its effect to simplify litigation would be identical.

It would, in other words, impose a threshold test to say, in essence, is this case worth it, and it would do that by asking whether there is competition in the market. Let me go back to two prior illustrations.

The milk case about which you had a dialogue with Mr. Leonard—I would agree that the milk situation is one in which exclusive territories would be wrong. Why? Because under the statute, under the Federal Marketing Act and the New York restrictive legislation, there was no competition in the distribution of milk.

One person had the entire distribution legal authority, not two, not three, not five, not ten. That case would, under this legislation, be subject to a full-blown antitrust hearing.

Then let me return to the Pennsylvania case which Mr. Constantine sought to address. Let me read from that opinion in contrast to his statements, because he said to Senator Metzenbaum that this was a horizontal conspiracy.

The opinion at page 18, and I am quoting: "The complaint alleges nothing more than a classical vertical restraint which is protected by the specific provisions of the Act," and they are referring to the 1980 Act, "and we do not believe we are required to allow this case to proceed on the facts alleged."

I would therefore also request permission, Senator, to enter into the record in substantiation of my statement, the entire case of *Commonwealth of Pennsylvania* v. *Pepsico* at 658 Federal Supplement 816, which makes clear that it is, as the court says, a classical vertical restraint case.

Senator DeConcini. Without objection, it will appear.

I have a number of other questions, but time is fleeting by and I am going to ask, Mr. Gellhorn, if you would respond in writing to us to the testimony given by Mr. Rule for the record.

[The aforementioned material follows:]

RESPONSE OF ERNEST GELLHORN TO TESTIMONY OF ASSISTANT ATTORNEY GENERAL CHARLES RULE ON S. 567

These comments are submitted at the request of Senator DeConcini for my views on the testimony presented by Charles F. Rule, Assistant Attorney General, Antitrust Division, Department of Justice, on August 4, 1987 concerning S. 567. While consistent with the previous position of the Department, I believe Mr. Rule's remarks reflect a fundamental misreading of the Malt Beverage Interbrand Competition Act ("S. 567" or the "Act") and, as a result, a misunderstanding of its effect.

Before outlining the most serious flaws in Mr. Rule's statement, it is important to give some context to his remarks. In recent years, the Department of Justice has not taken a major role in investigating or litigating antitrust issues involving vertical practices such as exclusive territorial franchises. It has focused instead on rewriting the primary rules of antitrust. As a result, it has lost its close familiarity with certain once-active antitrust areas. Vertical restraints is one such area.

The Department's lack of current experience in vertical restraints, particularly with respect to the impact of private actions on manufacturers and distributors, gives an air of unreality to Mr. Rule's statement. It appears to have led him into a false premise which infects the entire statement. Mr. Rule argues that S. 567 "is unnecessary because the courts, as well as the antitrust enforcement agencies, have already adopted a sound economic approach to analyzing vertical territorial arrangements among manufacturers and distributors under the antitrust laws."

If only this were the case! Unfortunately, nothing could be farther from the truth. To be sure, the Department and the courts have made great progress since the irrational, dark antitrust days when United States v. Arnold Schwinn & Co., 388 U.S. 332 (1967) was the law of the land and territorial provisions in distribution contracts were automatically illegal under the *per se* rule. But the fact of the matter is that the

1977 Sylvania case -- which reversed Schwinn and applied a rule of reason test -- did not answer all questions. Instead, as is commonly acknowledged, the Sylvania case spawned a torrent of litigation and has led to the widespread complaint that the rule-of-reason standard is causing undue confusion and uncertainty among lawyers and businessmen.*/

The Supreme Court's recent action granting certiorari in Business Electronics Corp. v. Sharp Electronics Corp., 780 F.2d 1212 (5th Cir. 1986), cert. granted, No. 85-1910, 55 U.S.L.W. 3820 (U.S. June 8, 1987) is further recognition of this uncertainty and need for clarification of the rule in vertical restraint cases. The Fifth Circuit's opinion in Business Electronics outlines the sharp division among the circuits. It viewed the problem as being so severe that one judge went so far as to urge the Supreme Court "to review its Russian roulette approach."

As a result, businesses and courts are faced with continuous litigation on vertical issues, particularly litigation brought by private parties. This litigation is generally unjustified; plantiffs ultimately lose the vast majority of cases. But the key word is "ultimately." What is missing is a process for quickly and efficiently screening unmeritorous claims. Without any filter, vertical antitrust cases regarding exclusive territories in the malt beverage industry are placing an undue burden on the parties involved as well as on our judicial system.

While Mr. Rule may be correct in the confidence he has in the Department's ability to apply the antitrust laws to vertical arrangements in a way that promotes consumer welfare, that cannot be said for all other governmental and private parties. Further, his statement that "exclusive territorial arrangements have been negotiated freely [since Sylvania] without fear of unreasonable antitrust condemnation" assumes particular irony given the lawsuits in Pennsylvania challenging the use of exclusive territories for soft drinks and in New York for beer distribution -- and the Department's more careful statement in 1985.*/

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*/ As I noted at the August 4, 1987, hearings, this problem is a source of constant commentary by business lawyers of whatever antitrust persuasion. See generally, Symposium, Management Discretion and Antitrust (The Conference Board Research Bulletin, Antitrust Forum 1984); Panel, Making the Rule of Reason Analysis More Manageable, 56 Antitrust L. Rev. 193-212 (1987); Flynn, The "Is" and "Ought" of Vertical Restraints After Monsanto Co. v. Spray-Rite Service Corp., 71 Cornell L. Rev. 1095, 1148 (1986) (law of vertical restraints is commonly recognized to be in a "state of disarray").

He fails to recognize the chilling effects of uncertainty and unreasonable antitrust litigation. Notwithstanding the fact that exclusive territories are invariably sustained, the costs associated with a lengthly antitrust trial applying the rule of reason can only deter manufacturers and distributors from relying on such contracts. This not only deprives business of the chance to seek the most efficient form of distribution, but also deprives consumers of the benefits associated with exclusive territories. The testimony of wholesalers on August 4 is vivid support for this finding.

Mr. Rule also mistakenly suggests that S. 567 would change the substantive standards governing the use of exclusive territories in beer distribution, and, in the process, somehow lessen the level of antitrust scrutiny. Despite his conclusory comments, S. 567 does not in fact alter the substantive standards for antitrust liability. It provides only a procedural check point for fruitless litigation by clarifying how traditional antitrust standards are to be applied in a vertical restraint context.

By establishing a threshold test of "substantial and effective competition," S. 567 provides a means for screening out those antitrust challenges to exclusive territories in which there is no possibility of harm to competition or consumers. The Department does not challenge this basic point that vertical restraints cannot cause competitive harm in markets facing substantial and effective competition. Indeed, it could hardly do so since its Vertical Restraints Guidelines, start from the very same premise.

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*/ The uncertainty of the Sylvania test and the costs it imposes were a primary justification offered by the Department of Justice for its Vertical Restraints Guidelines, 50 Fed. Reg. 6263 (Feb. 14, 1985):

> "The courts have been applying the economic analysis required by Sylvania to the facts of particular cases before them, but the method of antitrust analysis in this area remains somewhat uncertain. As a result, businesses may be deterred from using procompetitive vertical practices by the prospect of long and costly litigation and unpredictable results. The economy is harmed when lawful, efficient conduct is avoided because of legal uncertainty." (emphasis added)

A review of the Department's Vertical Guidelines suggests a further inconsistency in Mr. Rule's position. For it is these Guidelines that introduced a structured two-step process for determining when the Sylvania rule-of-reason test is appropriate, just as does S. 567. That is, instead of passively accepting a lengthy rule of reason trial, S. 567 would authorize courts to dispose of such lawsuits at an earlier, more reasonable point in the litigation.

In the absence of this threshold test, exclusive territory cases are costly and almost endless, as illustrated by the New York beer litigation. The effectiveness of the "substantial and effective competition" test, on the other hand, is demonstrated in cases litigated under the Soft Drink Interbrand Competition Act of 1980, 15 U.S.C. § 3501. For example, in Commonwealth of Pennsylvania ex rel. Zimmerman v. Pepsico, Inc., 658 F. Supp. 816 (M.D. Pa. 1987), appeal filed, No. 87-535 (3rd Cir. 1987), a lawsuit brought by the Pennsylvania state attorney general challenging the use of exclusive territories by Pepsico was dismissed four months after the filing of the complaint when the trial court found the market to be highly competitive.

Given this experience under the Soft Drink Act, Mr. Rule's concern that the "substantial and effective competition" standard will introduce confusion rather than clarity is unfounded. He points to no cases where the courts have been confused or where the standard was difficult to apply. Nor can he do so. The district court judges who have been called on to apply the identical language in cases involving the soft drink industry (including Judge Caldwell who decided the Pepsico case) have been able to act decisively and quickly -- exactly as Congress intended.

In addition, the statutory language has a clear, "common-sense" meaning in light of the substantive antitrust standards governing the use of vertical restraints. Mr. Rule's argument is also contradicted by long experience with similar antitrust criteria in other statutes, including the "substantially lessen competition" standard of Sections 3 and 7 of the Clayton Act. There is no reason why the experience there would not be achieved under S. 567.

Finally, Mr. Rule suggests the possible need for heightened scrutiny of the malt beverage industry because of alleged structural characteristics and the Department's ongoing investigation of price-fixing and other possible collusion in the soft drink industry. However, whether the sins of a few mistaken individual employees or companies can reasonably be attributed to the entire soft drink industry and then be visited upon brewers and beer distributors seems fanciful. It should be noted that Mr. Rule was careful to limit his description of price-fixing investigations to the soft drink industry; there are no such charges or investigations against members of the malt beverage industry. Nor does S. 567 in any way limit or impede the coverage of the antitrust laws against price-fixing in the malt beverage industry. The weakness of Mr. Rule's argument seems reflected in this effort to overstate the meaning of these charges.

On the other hand, the existence of these investigations and prosecutions of price-fixing by soft drink bottlers demonstrates what the proponents of S. 567 have long argued, namely that anticompetitive horizontal activities are not immunized by the Soft Drink Act, nor would they be by S. 567. The relationship between vertical exclusive territories and price-fixing or other horizontal collusion is unproven and unlikely. The assertion is an obvious non sequitur. How else explain the Department's other recent investigations and indictments involving price-fixing in such unconcentrated markets as antique auctions where dealers allegedly conspired to reduce the prices paid for goods sold at auction?

Nor does Mr. Rule explain how the intense competitive struggle among brands for the consumer's dollar squares with his view that malt beverage industry is oligopolistic and noncompetitive. Recent entry, price wars and trends, and changing market shares all point to the opposite conclusion. In any case, S. 567 has no relevance in uncompetitive markets. By its terms, it applies only when "substantial and effective competition" is present, and thus only in circumstances where arrangements can cause no competitive harm.

Thus, Mr. Rule's conclusion that S. 567 would "relax[] antitrust safeguards against collusion in the malt beverage industry" is inaccurate and unsupported. S. 567 does not change any substantive antitrust standard and, indeed, its express recognition in Section 3 that horizontal activities such as price-fixing will not be affected should ensure that any anticompetitive conduct can be promptly addressed.

In sum, there is an inconsistency and unreality about Mr. Rule's testimony reflecting a theoretical confusion that underlies his position. On the one hand, he recognizes the many benefits that exclusive territories may bring. He also acknowledges the desirability of finding effective procedural short-cuts in antitrust rule of reason cases. But he fails to apply this learning to the malt beverage industry because of asserted theoretical objections to single-industry statutes and a myopic view of recent unrelated events involving some soft drink bottlers.

The hard realities, never addressed by Mr. Rule, are that the current uncertainties of the antitrust law of vertical restraints impose unduly heavy costs on beer distributors. Competition that fully benefits consumers depends on each manufacturer being free to select the most effective distribution system with his distributors. As the law is currently written, that choice is heavily constrained by legal uncertainty. Congress should act to relieve the malt beverage industry of this burden. S. 567 is carefully crafted to meet this need. It is a "good law, good for competition, and good for consumers."

Senator DECONCINI. Also, without objection, I am going to enter testimony here by Mr. Frank Parker, President of Sound Distributing Corporation of New York City in support of the legislation.

[The following was received for the record:]

TESTIMONY OF FRANK PARKER

PRESIDENT, SOUND DISTRIBUTING CORPORATION

NEW YORK, NY

Dear Mr. Chairman:

As a beer wholesaler who is fighting to survive in the wildly competitive New York City market, I welcome the opportunity to express my strong support for S.567 and to clear up some obvious confusion about the situation facing beer distributors in New York City.

The Subcommittee has heard about the New York law suit in which it is alleged by the state Attorney General that because of an exclusive territory agreement entered into by two major breweries with their wholesalers, consumer prices rose by 35% over a 2½ year period. There are only two things wrong with the Attorney General's facts:

1. Wholesale price increases over the period in question were nowhere near what the Attorney General says he found at the retail level. If that's his evidence, why doesn't he have the retailers in court? I can tell this Subcommittee that if my wholesale prices rose by even 10 percent in that period, I would be in a lot better financial condition than I am today. The truth is that the wholesalerin New York City today is in a state of near depression, forced by the hot competition that exists to sell below cost in many cases. I sold a case of Bud in 1983 for $9.50. Today, I sell the same case for $8.30.

2. The second fallacy, in the Attorney General's hypothesis is that because Budweiser and Miller entered into paper agreements to have exclusive territories, those arrangements were actually implemented. I am here to tell you they were not. From the day those contracts were signed, sales by transshippers in the New York area have never fallen below 50% of the total market. The plain truth is that the brewers have never enforced the so-called exclusive territories, in part, because they didn't want to be brought into an antitrust law suit. The result has been competition that crosses territory lines with impunity.

Mr. Chairman, my firm, Sound Distributing Corporation has been in business since 1971, employs 165 people, mostly unionized and minority people. We have had to operate in a cut-throat atmosphere for a long period of time, watching numerous transshippers place hundreds of thousands of cases into our market, often ignoring state, federal and local taxes. We have attempted to compete against these transshipping wholesalers - but have found it extremely difficult given the high-taxes, significant overhead, unionized environment we are forced to operate in.

In response to these conditions, our firm has taken and will continue to take several affirmative steps. During late 1983, our firm confronted our union, seeking to reduce our costs relative to the non-union transshippers. We took an 18 week strike, laid-off 125 employees and won significant concessions from our employees. We reduced our prices on all of our products and enlarged our discounts to larger retailers. We have essentially elimnated our local marketing and charitable participation. We streamlined our costs and eliminated our community involvement as well.

My firm has established several remote retailer pick-up operations, where we encourage retailers to pick-up our products and those of others at very low prices. These operations are leanly staffed and all transactions are strictly on a cash and carry basis. This enables us to sell more of our products in an extremely competitive marketplace. As we have continued to reduce our prices and overhead, we experienced a loss of control, more specifically, our ablility to introduce and establish new brands and packages has virtually disappeared.

We have reduced our truck fleet by 50% since 1985 and are rapidly turning into a "Beer Broker," an operation which is extremely lean, offers large discounts, and avoid dealing with "expensive accounts" - usually smaller "mom & pop" type retail establishments. We seek to find customers who can purchase large quantities of our products and who will pay in advance. Our margins are razor-thin now and show no sign of increasing.

Finally, we have notified all of our suppliers that our historical participation in their numerous marketing and community grass-roots programs are simply a luxury we can no longer afford. These programs while certainly beneficial to retailers and the community at large, are burdensome overhead, something my competitors do not have.

With respect to prices, I must inform you that wholesale prices have never been lower than they currently are in New York City. This is the result of tremendous levels of transshipping, but at the expense of product freshness and tax collection at the federal, state and local levels. In fact, my own firm has been the subject of many complaints from transshippers to various New York State agencies including the New York State Liquor Authority. Essentially these complaints claim that our prices are "too low." Verification of these complaints can be made by contacting the New York State Liquor Authority directly.

In terms of supplier enforcement of exclusive territories in New York State, let me say that these contractual agreements are largely ignored by both brewer and wholesaler, and transshipping continues to grow each year in New York. The proof of this is seen in the number of wholesalers who are no longer in business in New York state and by the concentration which is just beginning to form in the distribution end.

Should this problem not be addressed soon, the very concentration our opponents fear - will surely manifest itself.

Thank you.

Senator DECONCINI. I am going to yield to my friend from New Hampshire, if he has any questions of these witnesses.

Senator HUMPHREY. I have none.

Senator DECONCINI. Do you have a statement or anything you would care to make at this time?

Senator HUMPHREY. That has been taken care of.

Senator DECONCINI. Very good. Thank you.

Thank you, gentlemen, very much for your time, and I am sorry about the vote interruption here.

In the next panel we will hear from Albert E. Lees, President, CEO and Treasurer of Lees Supermarket, Westport, Massachusetts; Matthew R. Dee, Treasurer, National Beer Wholesalers' Association, and President, United Beverage Company, South Bend, Indiana; and Michael J. Henry, President of the California Fruit Market, Incorporated, on behalf of the Vermont Retail Grocers Association.

I am advised that Senator Kennedy had planned to come over here, Mr. Lees, to introduce you. Apparently, you are friends, and he just sent word to me that he cannot be here today at this moment.

Before we start, gentlemen, I would have the record show the following document being attached to the statement of Mr. Gellhorn as supplemental due to time restraints.

[The following was received for the record:]

APPENDIX 3A

JONES, DAY, REAVIS & POGUE
WASHINGTON, D.C.

MEMORANDUM

TO: National Beer Wholesalers' Association, Inc.
FROM: Ernest Gellhorn
DATE: February 18, 1987
SUBJECT: Analysis of Litigation Involving Challenges To The Use of Exclusive Territorial Limitations

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One of the primary goals of the Malt Beverage Interbrand Competition Act ("the Act") is to reduce the significant cost associated with litigation involving challenges to the use of exclusive territorial franchises and other geographic limitations in beer distribution. Such litigation costs directly affect the beer industry both through direct expenditures (such as legal fees) and other indirect costs (such as the disruption of ongoing business activities resulting from litigation demands on key personnel). These costs, of course, are ultimately passed on to consumers in the form of higher prices for beer and malt beverage products.

Effect of Passage of the Malt Beverage Act on Litigation Involving Exclusive Territories

Passage of the Act should reduce litigation expenditures in two ways. First, by clarifying the legal standard to be applied to challenges to exclusive territories, the Act should limit the number of unsubstantiated and unwarranted lawsuits challenging these practices. Second, by establishing a threshold test for analyzing the legality of exclusive territories, the Act should similarly reduce the scope and complexity of any lawsuits filed.

The Act would require an initial determination by the court whether "substantial and effective competition exists" among malt beverage brewers and wholesalers in a particular geographic area. If this finding can be made, the antitrust action would be dismissed, since the existence of substantial and effective competition prevents any injury to consumers as a result of use of exclusive territories. If such competition were not found, however, the court would proceed to analyze the use of exclusive territories under the rule of reason standard established by the Supreme Court in Continental T.V., Inc. v. GTE Sylvania, Inc. and determine whether the practice substantially lessened competition in violation of the Sherman Act. Use of this threshold test can be expected to screen out many non-meritorious lawsuits at an early stage, thus reducing the need for extensive discovery, unnecessary jury trials, etc.

Some opponents have asserted that there is no need for passage of the Act because the legal standards to be applied to vertical practices are clear and because antitrust challenges to the use of exclusive territories are seldom, if ever successful. Neither of these arguments is persuasive. The Supreme Court in GTE Sylvania did little to explain the application of the rule of reason test and subsequent decisions by courts (and particularly by juries) have generally confused rather than clarified the standard. As a result, as one antitrust scholar recently commented,

> "One cannot survey the post-Monsanto litigation without concluding that the law [of vertical restaints] is presently in a state of disarray."1/

The beer industry is particularly affected by this uncertainty because of its widespread use of exclusive geographic territories. Given the current legal climate, brewers and wholesalers are understandably hesitant to institute certain vertical practices that may increase the effectiveness of their operations but, in so doing, subject them to the costs and vagaries of litigation.

This remains true despite the fact that there have been relatively few cases (particularly when compared to the number of complaints filed) in which antitrust liability for the use of exclusive territories in the beer industry ultimately was found. This record, if anything, increases the need for

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1/ Flynn, "The 'Is' and 'Ought' of Vertical Restraints After Monsanto Co. v. Spray-Rite Service Corp.," 71 Cornell L. Rev. 1095, 1148 (1986).

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passage of the Act. No consumer benefit is achieved by challenging a lawful practice and, as described above, these attempts inevitably result in significant costs and disruption of business activities. Since the ultimate legal vindication of the use of exclusive territories often only comes after extended legal battles (frequently including appeals to higher courts), any meritless litigation imposes unacceptably high costs.

An examination of litigation concerning the use of exclusive territories in beer distribution since the 1977 Supreme Court decision in GTE Sylvania demonstrates the scope of the problem faced by the beer industry. Litigation involving territorial restrictions has arisen in a number of ways. Some cases have involved direct challenges to a brewer's systematic use of exclusive territories. Other antitrust challenges to the use of exclusive territories have been raised in disputes between a wholesaler and a brewer. This scenario has been particularly common in attempts to replace one exclusive distributor with another, or in cases in which a distributor is terminated for sales that violate a brewer's quality control or distribution standards. Finally, antitrust complaints regarding the use of exclusive territories have been brought by beer retailers, who have alleged various anticompetitive effects resulting from the practice.

A selection of illustrative cases involving these issues are discussed in the following summary. Because the memorandum focuses principally on reported decisions of the federal courts, it understates the extent of prior litigation. For example, it does not reflect those cases that were settled without judicial adjudication or that were resolved in a manner that did not produce a published opinion (such as by a jury verdict). The summary also does not reflect litigation brought in state courts under state antitrust laws.

Finally, for purposes of comparison, this memorandum reviews the lawsuits brought in the same period challenging the use of exclusive territories in the soft drink industry. As

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demonstrated below, since the passage of the Soft Drink Interbrand Competition Act of 1980, Pub. L. No. 96-308, 94 Stat. 939, few if any such lawsuits have been filed. Those that have been filed have been resolved by reference to the Soft Drink Act's threshold test. Thus, the experience of the soft drink industry provides clear evidence that the approach contained in the proposed legislation would be effective in reducing unnecessary litigation.

Selected Litigation Involving Antitrust Challenges to the Use of Exclusive Territories in Beer Distribution

One example of ongoing litigation that would be subject to the provisions of the Act is the pending lawsuit filed by the New York State Attorney General seeking to enjoin the use of exclusive territories in that state. The Attorney General's complaint, New York v. Anheuser-Busch, Inc., No. CV-86-2345 (E.D.N.Y., filed July 15, 1986) seeks to certify a defendant class of franchised beer wholesalers and alleges a series of vertical agreements between brewers and their franchised wholesalers to establish exclusive geographic territories. It also asserts the existence of horizontal conspiracies between wholesalers to allocate these geographic territories. According to the complaint, the effect of these agreements is to reduce competition in the distribution of beer in New York State.

Although the New York Attorney General seeks only injunctive relief and civil penalties, this lawsuit has already triggered a series of related private actions by New York independent wholesalers and beer retailers seeking treble damages. These include Vasiliow Co., Inc. v. Anheuser-Busch, Inc. 86-CV-3227 (E.D.N.Y.); Uniondale Beer Co., Inc. v. Anheuser-Busch, Inc., 86-CV-2400 (E.D.N.Y.); Cumberland Farms, Inc. v. Anheuser-Busch, Inc., 86-CV-3277 (E.D.N.Y.); and Terrace Pub, Inc. v. Anheuser-Busch, Inc. (S.D.N.Y.). The plaintiffs in these lawsuits are seeking certification of various plaintiff classes, including all independent

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wholesalers and all retailers who purchased beer in New York State from a franchised wholesaler. If the proposed classes were certified, the cost of defending the ensuing lawsuits would be enormous and the potential antitrust liability would be significant.

Passage of the Act would significantly simplify the judicial resolution of both the New York Attorney General's lawsuit and the private litigation. Application of the threshold test of substantial and effective competition would provide an early opportunity to evaluate and dispose of the vertical allegations relating to the use of exclusive territories. This approach has particular value in a class action setting, which involves complex and extensive claims. The horizontal issues of market allocation and price-fixing raised by the Attorney General's lawsuit would not be affected by passage of the Act; these allegations, which rely on different legal theories and elements of proof, would, in any event, be considered separately from the various vertical claims.

The various New York lawsuits are not the only example of litigation raising class action challenges to the use of exclusive territories. A similar issue was presented in Mekani v. Miller Brewing Co., 1982-1 Trade Cas. (CCH) ¶ 64,563 (E.D. Mich. 1982), where two Michigan beer retailers sought to certify a class action lawsuit against six major brewers and a number of beer distributors. The lawsuit alleged that the price of beer in Michigan was artificially high because the distributors and brewers conspired to fix prices and maintained non-competitive exclusive territories. The district court refused to certify the class on the grounds that individual issues predominated over questions common to the class as a whole.

While the initial focus on market power represented by the Act's "substantial and effective competition" test has already been adopted by some courts, it is used all too infrequently. When used, however, this approach has clearly demonstrated its

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effectiveness as a method of resolving vertical restraints claims involving the use of exclusive territories. For example, in Assam Drug Co. v. Miller Co., Inc., 624 F. Supp. 411 (D.S.D. 1985), aff'd, 798 F.2d 311 (8th Cir. 1986), a beer retailer alleged that Miller had unreasonably restrained trade through the use of distribution agreements establishing exclusive territories limiting the areas in which distributors could market Miller's products. The district court granted Miller's motion for summary judgment on the ground that the retailer had failed to show that Miller had a dominant share of the relevant market. This conclusion was affirmed on appeal.

In the absence of a focus on the critical issue of market power, litigation involving the use of territorial restrictions can be drawn-out and burdensome, particularly in the case of non-meritorious challenges. A brewer or distributor involved in such challenges can incur a significant disruption of business activities as a result. For example, Coors, a brewer that has traditionally used a system of territorial restrictions to ensure that product quality control procedures (such as constant refrigeration) were observed, has been a frequent target of antitrust challenges to the use of exclusive territories.

In Mendelovitz v. Adolph Coors Co., 693 F.2d 570 (5th Cir. 1982), a lawsuit was filed challenging Coors' decision to cut off all sales to a beer wholesaler that had sold Coors' beer outside of its area of authorized distribution. The wholesaler brought suit, alleging that Coors and its distributors had conspired in violation of Section 1 of the Sherman Act through the establishment of territorial restrictions and a concerted refusal to deal. The district court granted Coors' motion for a directed verdict on the grounds that the territorial restrictions were not unreasonable and that the wholesaler had failed to show that the refusal to deal had an anticompetitive effect. The court of appeals affirmed, finding that the wholesaler had not shown that Coors' actions had an adverse impact on interbrand or intrabrand competition in any relevant market.

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Similarly, in Maykuth v. Adolph Coors Co., 690 F.2d 689 (9th Cir. 1982), Coors terminated a distributor who shipped Coors' beer outside his assigned territory in unrefrigerated trucks, in violation of quality control standards. The terminated distributor sued, alleging that Coors' system of territorial restrictions constituted price-fixing and an unlawful territorial restraint in violation of Section 1. The district court dismissed the lawsuit, finding that the distributor had failed to show that Coors' conduct violated the Sherman Act. The court of appeals again affirmed.

ABA Distributors Inc. v. Adolph Coors Co., 496 F. Supp. 1194 (W.D. Mo. 1980), rev'd, 661 F.2d 712 (8th Cir. 1981) involved a lawsuit by a Coors distributor terminated for selling beer for resale outside its territory. ABA sought a preliminary injunction enjoining its termination pending trial, which was granted by the district court. On appeal, the Eighth Circuit dissolved the preliminary injunction because ABA had not shown it would be irreparably harmed before trial by the termination. See also Del Rio Distributing Inc. v. Adolph Coors Co., 589 F.2d 176 (5th Cir. 1979) (affirming jury verdict finding that terminated distributor had failed to establish any violation of antitrust laws from brewer's limiting territories where beer could be resold).

The issue of the legality of exclusive territories under the antitrust laws has also frequently arisen in the context of disputes regarding the substitution or termination of exclusive distributors. For example, in Crown Beverage Co., Inc. v. Cerveceria Montezuma, S.A., 663 F.2d 886 (9th Cir. 1981), Cerveceria, a brewer of Mexican beer, transferred the exclusive distributorship of its brands from Crown, its former distributor, to a newly formed subsidiary. Crown challenged this conduct both as a violation of the Sherman Act and as a breach of contract. The Ninth Circuit affirmed the district court's grant of summary judgment on the antitrust claims, determining that, absent anticompetitive conduct or intent, such changes of distributors are permitted by the antitrust laws.

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In Carlo C. Gelardi Corp. v. Miller Brewing Co., 502 F. Supp. 637 (D.N.J. 1980), aff'd, 720 F.2d 660 (3d Cir. 1983), a beer distributor alleged that Miller violated the Sherman and Robinson-Patman Acts by establishing a competitor in what was formerly Gelardi's exclusive territory and by conspiring with the competitor to drive Gelardi out of business. The district court concluded that Gelardi had not shown any evidence of a conspiracy or combination and granted summary judgment on the Sherman Act claims. On appeal, the Third Circuit affirmed.

In Suburban Beverages Inc. v. Pabst Brewing Co., 462 F. Supp. 1301 (E.D. Wis. 1978), an about-to-be-terminated distributor was denied a preliminary injunction, despite alleging that its termination for refusal to agree to territorial limitations on resale was a violation of the antitrust laws. The court concluded that under the rule of reason standard, the distributor had failed to establish the likelihood of success on the merits necessary for issuance of an injunction.

In Best Brands Beverage, Inc. v. Falstaff Brewing Corp., 1985-2 Trade Cas. (CCH) ¶ 66,820 (S.D.N.Y. 1985), Falstaff attempted to end Best's exclusive distributorship by creating a new "dual master distributor" in Best's territory. Falstaff also allegedly increased the prices of its products sold to Best but not to any other distributor. The district court granted Best's motion for a preliminary injunction and issued an order nullifying the price increases and restraining Falstaff from interfering with Best's exclusive distributorship. No subsequent action by the court has as yet been reported.

In Standard Liquor Corp. v. Olympia Brewing Co., 1983-1 Trade Cas. (CCH) ¶ 65,230 (D. Kan. 1982), a Kansas beer distributor sought an extension of a temporary restraining order which prohibited Olympia, a brewer, from terminating its distributorship agreement and substituting a new distributor. Standard alleged that its termination violated Kansas antitrust law. The district court allowed the injunction to expire

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because Standard failed to show irreparable harm as a result of the termination. In support of its decision that the court pointed out that Standard had not been forced out of business by the termination of its supply of Olympia beer because of the availability of other products. The court also found that there had been no showing of anticompetitive intent on the part of Olympia and stated that the mere substitution of distributors does not constitute a violation of the antitrust laws.

In *Kestenbaum v. Falstaff Brewing Corp.*, 575 F.2d 564 (5th Cir. 1978), the Fifth Circuit reversed a jury verdict finding that local advertising and warehouse requirements associated with a system of geographic territories represented an antitrust violation. It found, rather, that requiring a dealer to provide adequate service inside a territory through such measures is likely to further competition by increasing interbrand rivalry.

In *Mary Ann Pensiero, Inc. v. Lingle Co.*, No. 86-0144 (M.D. Penn., June 6, 1986), the court reviewed a challenge to an exclusive distribution plan. Pennsylvania state law required out-of-state brewers to designate an exclusive importing distributor for each geographic territory established by the brewer. The plaintiff alleged that Lingle, the exclusive distributor for Anheuser-Busch and Genesee, monopolized these products in violation of the Sherman Act. The court granted Lingle's motion for summary judgment, rejecting the argument that the relevant product market consisted of brands of beer produced by two particular breweries. It found that the relevant product market was all brands of beer and that the exclusive distributorship did not amount to monopolization of this market.

In *Skyview Distributing, Inc. v. Miller Brewing Co.*, 1977-1 Trade Cas. (CCH) ¶ 61,803 (D. Utah 1977), *rev'd*, 620 F.2d 750 (10th Cir. 1980) a former Miller distributor alleged that

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Miller violated the antitrust laws by encouraging Skyview to overexpand so that it encountered financial difficulties. Miller subsequently terminated Skyview's distributorship and granted an exclusive distributorship to Star, an entity allegedly created by Miller to further a policy of eliminating those distributors who carried competing brands of beer. The district court granted defendants' motion to dismiss finding that the complaint failed to allege a combination or conspiracy on the part of Miller and Star. The court of appeals reversed the district court's decision, determining that Miller had to act in concert with Star in order to carry out its plan. Following remand to the district court, no subsequent opinions are reported, suggesting that some type of settlement was reached.

The issue of exclusive territories can also arise in antitrust challenges involving retail distribution. In Fragale & Sons Beverage Co. v. Dill, 760 F.2d 469 (3d Cir. 1985), Fragale, a retail beer distributor, alleged that two wholesale beer distributors and another retailer had conspired to keep it out of the Cameron County retail beer market by refusing to sell it beer. Fragale alleged that this was a per se conspiracy or, alternatively, was unlawful under the rule of reason because it unduly restrained trade by creating a situation in which there was only a single beer retailer in Cameron County. The district court granted summary judgment for defendants. The Third Circuit reversed, determining that the district court, as a matter of law, was unable to determine that a reasonable jury could not find unlawful concerted activity on the part of the defendants. The Third Circuit remanded the case to the district court for further proceedings.

Litigation Involving Challenges to the Use of Exclusive Territories in the Soft Drink Industry

Since the passage of the Soft Drink Act in 1980, there have been relatively few challenges to the use of exclusive

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territories in soft drink distribution.2/ Coca-Cola Co. v. FTC, 642 F.2d 1387 (D.C. Cir. 1981), a case in which the Federal Trade Commission challenged the territorial exclusivity provisions contained in Coke and Pepsi's trademark licensing agreements, was pending before the D.C. Circuit at the time the Soft Drink Act was passed. Following passage, all parties subsequently agreed that the new Act controlled the litigation and that the FTC's orders should be set aside and the complaints dismissed. Id. at 1389.

In Pepsi-Cola Metropolitan Bottling Co., Inc. v. Checkers, Inc., 754 F. 2d 10 (1st Cir. 1985), a soft drink bottling company sought to collect a debt from one of its customers, which asserted as a defense the allegedly illegal system of exclusive territorial dealerships maintained by Pepsi. The jury rejected this antitrust claim and the First Circuit noted "to the extent there was any question whether Pepsi-Cola, Inc. and Metropolitan were entitled to limit sales so as to maintain Pepsi's system of exclusive territorial dealerships, their right to do so was bolstered by the Soft Drink Interbrand Competition Act. . . ." Id. at 18.3/

Finally, in Troop v. Central Investment Corp., No. 32396, Ohio Common Pleas Court, Ashland County (July 8, 1983), a Pepsi distributor's unilateral refusal to sell soft drinks to a convenience store that purchased the bulk of its Pepsi products from outside the distributor's exclusive territory was found not to violate federal or state antitrust laws. Finding that

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2/ The Pennsylvania State Attorney General recently filed a lawsuit alleging that PepsiCo, Inc. and two of its Pennsylvania bottlers conspired to enforce territorial restraints at the retail level and to boycott certain retailers in violation of the Sherman Act. Pennsylvania v. PepsiCo, Inc., CV-86-1799 (M.D. Pa., filed Dec. 22, 1986). This lawsuit will likely test the application of the Soft Drink Act to practices at the retail level.

3/ A similar point was recently recognized by the district court reviewing the merger challenge brought by the FTC to enjoin the acquisition of Dr. Pepper by the Coca-Cola Company. In describing the soft drink industry, the court noted that the major concentrate companies grant exclusive territorial rights to their bottlers and generally prohibit their bottlers from distributing competing flavors of other companies. While such restrictions may prevent intrabrand competition, the court found "[t]hey were insulated from federal antitrust scrutiny by the Soft Drink Interbrand Competition Act." FTC v. Coca-Cola Co., 641 F. Supp. 1128, 1134 n.15 (D.D.C. 1986).

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the exclusive territory was not an unreasonable restraint, the court noted that the Soft Drink Act "provides the federal policy which permits the granting of exclusive territory to soft drink bottlers and indicates that the Congress does not consider this arrangement to be an unreasonable restraint of trade." *See* 45 *Antitrust & Trade Reg. Rep. (BNA)* 130 (July 28, 1983).

Conclusion

This selective review of recent illustrative lawsuits involving territorial practices in the beer distribution industry demonstrates that the amount of such litigation is substantial. In contrast, the lack of comparable litigation involving the soft drink industry since passage of the Soft Drink Interbrand Competition Act in 1980 establishes that such clarifying legislation can have an impact in eliminating unwarranted litigation. Passage of the Malt Beverage Interbrand Competition Act would represent a significant step toward reducing the costs and inefficiencies associated with current litigation.

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Response Of Lloyd Constantine
Assistant Attorney General
In Charge
Antitrust Bureau

To

Statement Of Richard B. Willett
Before The
Subcommittee On Antitrust, Monopolies And Business Rights
Of The Committee On The Judiciary
United States Senate
Concerning S. 567
The "Malt Beverage Interbrand Competition Act"

Submitted for the record
October 16, 1987

This statement is submitted in response to testimony of Richard Willett, who was retained by the National Beer Wholesalers' Association to testify on its behalf before this Subcommittee on August 4, 1987. That same day, I had testified in opposition to the so-called "Malt Beverage Interbrand Competition Act" and had, among other things, advised the Subcommittee that surveys conducted in the regular course of business by the New York City Department of Consumer Affairs revealed that, for the period December 1982 to June 1987, beer prices rose approximately 39.5% while soft drink prices declined. Mr. Willett's testimony attempted to rebut my statement. Indeed, Mr. Willett introduced his own report, commissioned by the NBWA for purposes of supporting the legislation, which purported to show that beer price increases were not of the magnitude found by the State of New York surveys and were, at the wholesale level in any event, largely driven by cost increases (the Willett testimony with exhibits is attached for ease of reference).

Although we are not privy to Mr. Willett's methodology or to the underlying data used in this report, our review of his testimony reveals serious shortcomings and problems with his report that call into question its reliability.[1] We wish to bring those to the subcommittee's attention:

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[1] We do not have sufficient background information to comment on Mr. Willett's treatment of beer prices in Alabama and Illinois. We can only assume that they are marked by the same infirmities that characterize his report on New York prices.

1. Although Mr. Willett advised this Subcommittee that his report covered wholesale beer prices in New York City for a period which coincided with the period covered by the Attorney General's testimony, in fact the surveys relied on by our office were for the period 1982-1987, but Mr. Willett chose to examine only the period 1982-1985. Thus his report cannot be compared with our surveys' findings.

2. The Willett report employs a number of questionable devices in order to inflate cost increase while minimizing price increases over the period Mr. Willett chose to examine.

First and most important, the testimony excludes from the price side a de facto increase in both wholesale and retail prices due to the institution of New York's deposit law, apparently on the grounds that such increases have nothing to do with the institution of exclusive beer wholesale territories, or that the price increase "washes out" because of returns by consumers. On the cost side, however, Willett includes the payments to retailers and the recycling revenue arising from the container return program. See Willett Statement, Exhibit III at 9. The inclusion of these costs, when netted from the revenue gained from recycling, increases wholesalers' alleged cost increases over the period from \$0.40 - \$0.67/case to \$0.77 - \$0.97/case. But if the price increases occurring from the container return program are excluded from the cost/price calculation, so should the costs of the program. Netting out these costs yields only \$0.40 - \$0.67/case net cost increase to the wholesalers. These more modest cost increases do not justify the $0.88/case increase in wholesale beer prices which the Willett report concludes occurred.

Relying otherwise on Mr. Willett's figures, the net increase of wholesale prices over the wholesale costs, when the effects of the container return law are eliminated from both sides of the cost/price equation, is 31.3 percent to 120.0 percent, a much greater increase than the 10.2 percent to 14.4 percent calculated by Willett.

3. Much greater returns than those calculated by Willett are also evident at the retail level. If price increases pertaining to the container return law are excluded at the retail level, so too should the $0.30/case payment for handling returns. Willett in Exhibit III at page 9 of his testimony, however, includes a $0.30/case charge which lessens by 34% the net cost increase to the retailer during this period.

4. There is another factor arising from the institution of the bottle deposit program which Willett also conveniently ignores. His testimony points out that consumers can receive a refund of $1.20/case when they return containers. Since only 82% of cases are returned, however, the net return paid by the retailer is only $0.98/case ($1.20 x .82 - See Willett testimony at 3). Willett uses the $0.98 figure as a proxy for the wholesale and retail price increases attributable to the container return law. Id. But the $0.98/case figure has nothing to do with beer price increases (the price of beer is not regulated by the State at either the distributor or retailer level). Although Willett presents no data on this point, the

price increase in effect must be *at least* $1.20/case in order to cover the cost of the consumer refund, and upstream, the refund to the retailer. Since the beer wholesaler (not the State, or the brewer) originates the $1.20/case deposit fee, the difference between the $1.20 price increase to the consumer and the $0.98 actually paid out by the retailer (due to the 18% of containers not returned) is pure profit accruing back to the wholesaler. This very substantial amount -- $0.22 on each case of beer sold -- is absorbed by the wholesalers and more than compensates for the cost and inconvenience of handling returns. It adds to the price charged the consumer, decreases the cost to wholesalers, and adds to the profits of beer wholesalers in New York State.

5. With respect to Willett's cost/price workup in Exhibit III at page 9 of his testimony, it is curious that Willett *ranges* certain data (brewer price increases, revenues to distributors for recycling returns) while providing *averages* for other data (wholesale and retail price increases). All data should be averaged on a weighted basis if it is to possess any credibility whatsoever. As the data stand, there is wide disparity in results when comparing wholesaler cost increases over the period with the average increase in wholesale beer prices:

- Per Case Data -

Brewer price increase (ranged):	$0.60	$0.90
Additional tax:	$0.02	$0.02
Cost increase to wholesalers:	$0.62	$0.92

Simple Average ((62 + 92)/2) Cost Increase = $0.77

Average Wholesale Price Increase = $0.88

Increase in Price over Cost (Profit) = $0.11 or 14.3%

But actually, the "range" of brewer price increases tells us nothing. If the increase in brewer prices of popular brands was concentrated at the lower end of the range, which resulted, for example, in a weighted average brewer price increase of only \$0.65/case,[2] the excess of the wholesaler \$0.88 price increases over increased costs would be \$0.88 - \$0.65, or \$0.23. This would translate to an increase in wholesalers' profits of 36 percent, over double the 14 percent derived from Willett's numbers.

Similarly, the use of ranged data in the reporting of wholesaler recycling revenues can also be misleading. If the weighted average recycling revenue is toward the upper end of the range, at \$0.23/case, for example, the net increase in wholesaler prices over costs (profit) rises an additional 13 percent.

In any case, it is improper to compare ranged data with average data, as it can potentially lead to severe distortions of the "evidence," as demonstrated above.

6. Mr. Willett's method of making graphic representations of New York City wholesale beer prices (Willett, Exhibit I at page 4 of his testimony) and retail beer prices (Willett Exhibit II at page 8) are misleading if not downright deceptive. This is due to the vertical axis of the graphs being calibrated over such a large range (\$2 to \$15) that any price increases prevailing

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[2] As the popular brands of beer are the most competitive in price, the above is a likely scenario.

over the 1982-85 period look small in comparison. The axis of graphs should fit the recent history of the data being measured. When was the last period in which wholesale beer prices were $2/case in New York City? Yet the$2 figure is the starting point for the graphs. See the attached Appendix for an illustration of misrepresentative nature of the Willett graphs. In this Appendix, Willett's data used for his Exhibit I is graphed on a more representative scale. Price increases are readily apparent.

x x :: x

Perhaps most revealing about the Willett report on beer prices is what it omits: any reference to the history of soft drink prices during either the period covered by his testimony or that of our office. Mr. Willett's report takes a tortured and, as noted above, misleading approach to "factoring out" the effect of the beverage container deposit legislation on prices. Our approach was direct: we compared price increases for both soft drinks and beer, based on surveys not taken for the purpose of supporting our testimony.[3] Both soft drink and beer containers are treated alike under the container deposit law. Whatever system costs result for that law will presumably affect both types of beverages equally; therefore we did not try to factor out those costs or any cost-driven price increases. As a result, we believe it extremely significant that beer prices rose during the period examined, while soft drink prices fell. Our conclusion remains as we testified: the institution and maintenance of exclusive wholesale territories in the beer industry has had a pernicious effect on competition and on consumers.

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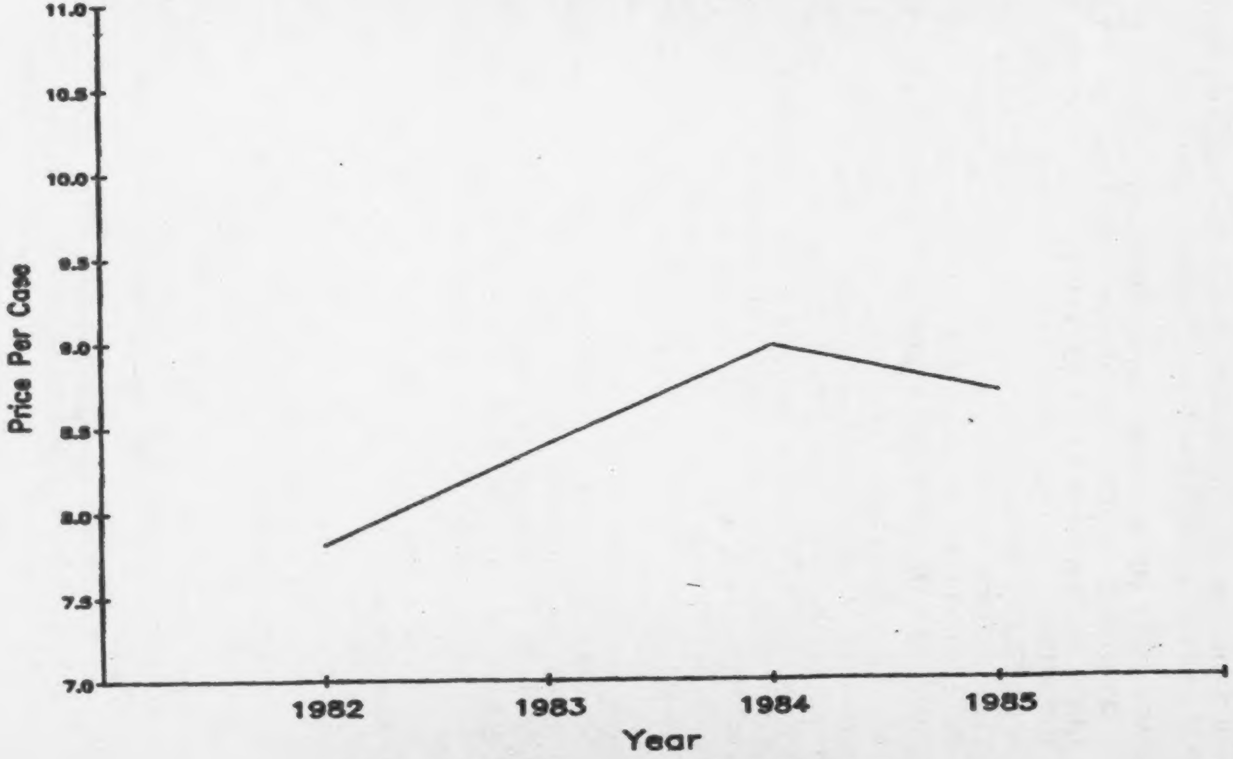
[3] As noted above, we are not privy to the methods by which Mr. Willett obtained information on wholesale beer prices, but we note that his collection and review of those prices was done with the objective of supporting his testimony in favor of the proposed legislation.

The most important point we wish to reiterate, however, does not depend on whether definitive proof exists that exclusive territories have already caused anticompetitive price increases in New York. The point is that the beer industry has not and cannot justify a need for special treatment under the antitrust laws. To the contrary, legislation insulating exclusive beer wholesaling territories from antitrust scrutiny can only work to the further detriment of the consuming public. Its purpose cannot possibly be to foster competition; the creation of a new standard can only be intended to exempt activities which could not pass muster even under the very lenient "rule of reason" standard applied to non-price vertical restraints. Even the current administration concludes that the beer industry's structure and use of exclusive territories predisposes it to anti-competitive behavior. Congressional endorsement of special treatment for such an industry would be a travesty.

Exhibit 1(a)
New York City Wholesale Beer Prices



Prices exclude deposit per case of 98 cents.

Senator DeConcini. We will start with Mr. Lees. Mr. Lees, if you would summarize your statement in 5 minutes, and then we will go to the next witnesses and then questions. Thank you, sir.

STATEMENT OF A PANEL CONSISTING OF ALBERT E. LEES, JR., PRESIDENT, CHIEF EXECUTIVE OFFICER, AND TREASURER, LEES SUPERMARKET, WESTPORT, MA; MATTHEW R. DEE, PRESIDENT, UNITED BEVERAGE CO. OF SOUTH BEND, INC., AND TREASURER, NATIONAL BEER WHOLESALERS' ASSOCIATION, SOUTH BEND, IN; AND MICHAEL J. HENRY, PRESIDENT, CALIFORNIA FRUIT MARKET, INC., ON BEHALF OF THE VERMONT RETAIL GROCERS ASSOCIATION, RUTLAND, VT

Mr. Lees. Good afternoon. I am Al Lees, owner of Lees Supermarket of Westport, Massachusetts, which is in the southeast corner of the State about halfway between Fall River and New Bedford, just a few miles from the Rhode Island line.

I am what is called a single-store operator in the grocery business. My store is about 33,000 square feet in size and I employ 68 people. We operate 7 days a week from 8:00 a.m. to 9:00 p.m.

As you know, the grocery business is highly competitive. In my marketing area, five major supermarket chains operate superstores or super-warehouse stores.

Senator DeConcini. Can you pull that microphone a little bit closer to you, Mr. Lees? Thank you, sir.

Mr. Lees. So independents such as myself have to be on our toes or go out of business. I carry almost 20,000 items in my store, which means there are a lot of decisions to be made daily. Let me explain why this is so.

The most recent and reliable study of our industry tells us that the average consumer makes 2.4 trips to a supermarket each week. They visit, on the average, 1.6 different stores; 2.4 trips to 1.6 stores. What that means to me is I have plenty of opportunities to lose my regular customers if I do not offer quality service and products at competitive prices, and that I do have a chance to pick up the other guy's customers if I do a superior job.

One of the things I do to make certain that I get the best possible deal for my customers is to buy from two different wholesale firms, one from Providence, Rhode Island, and the other from Boston, Massachusetts.

My experience is that I get the best prices and the best service all of the time for my one store and my customers because each wholesaler knows that I can go to another wholesaler for the same products in the same way that my customers can go to another store for the same products.

It all depends on price and service. Customers, retailers and wholesalers all know this process is going on. It is called competition and free enterprise. Of course, there are some exceptions to this method of operating. One is beer.

I know that you have been having hearings and debates about this beer bill for over 7 years. I am not a lawyer and I certainly do not know much of anything about antitrust policy, but I do have enough common sense and retail experience to support my family and myself.

I have read about the beer bill, as I have said, for 7 years and I would simply like to share with you the reaction of one person on the firing line.

First of all, I do not understand what is so special about beer as a commodity that it deserves the special treatment you are being asked to extend. If there is something wrong with the antitrust laws, you ought to fix them for everybody. If there is nothing wrong with them, leave them alone. Why a special fix for beer?

Second, why is it all right for me to shop for the best deal for my customers for the other 20,000 items I carry but not for beer? We do have exclusive territories now in Massachusetts. It seems to me that if the Federal Government gives its official blessing to this kind of arrangement, there will never be an opportunity for me to get the best deal possible for my beer customers the way I do for everything else.

Finally, if this special treatment is given to the beer industry, I wonder who will be next? Who else, 3 or 4 or 5 years down the road, will come before you and request a special exemption from the antitrust laws?

I understand that in some States exclusive territories are being given to wine distributors, so I presume they will be next and at the head of the line. Then who? Maybe supermarket operators such as myself ought to ask you to give us exclusive territories so that whoever lives in the southern half of Westport has to buy all of their groceries in Lees Supermarket. That is not a bad idea, probably.

Or maybe the car dealers will be next. If you want a Chevy and live here, you belong to this dealer, but if you live over there and want to buy a Chevy, then you have to go to that dealer.

Now, I am not sure what my beer distributor would feel when he went out to buy his new Cadillac for himself or his new Porsche for his son if he was told you cannot make the best deal; you must go to this particular Cadillac dealer or you must go to that particular Porsche dealer.

I know that all sounds rather silly, but it does not sound any sillier to me than the United States Congress giving a special antitrust exemption to the beer industry.

I have also heard some testimony today about the fact that the beer would be fresher and therefore would be better. Most people in the food industry and most people who are in the package store industry know about rotation and know that they have to keep fresh product. Milk only has 7-day codes, so we do know something about it.

I hope you turn this legislation down. More than that, I hope you kill it once and for all so that none of you has to waste any more time on this bad idea and so that our economy can operate the way it does the best, with everyone having an equal opportunity and no special deals for any group.

Thank you for listening to me.

Senator DeConcini. Mr. Dee.

Mr. Dee. Thank you, Senator. I am going to get away from my prepared testimony a little bit with regard to some of the statements that have already been made today because they really upset me.

First of all, I would like to tell Mr. Rule that there is a multitude of beer wholesalerships available in Indiana and he is welcome to come there and buy as many as he wants.

I appear today as an Indiana beer wholesaler who has been living with transshipping for 10 years now. I also represent some 1,800 beer wholesalers in the United States as an officer in their organization.

A couple of weeks ago, one of our association members sent me a copy of a letter he had received from his Congressman. That Congressman was expressing reservations about the bill before this subcommittee because he was not sure that it was in the interests of the consumer. He said that he had heard that there was a 20-percent decline in beer prices in Indiana after it issued its regulation barring exclusive territories.

Mark Twain wrote, a lie can get halfway around the world before the truth can get its shoes on. Amen. In this case, the tall tale of the so-called Indiana study appears to be starting its second orbit.

From the day this phantom Indiana study made its appearance on the public record, there has been definitive, authoritative and conclusive testimony that no such study ever existed.

According to the congressional testimony of Indiana Attorney General Lynly Pearson a few years ago, the whole thing was fiction spawned by a misinterpreted remark that a retailer could save as much as 20 percent on his cost of beer if he picked up his purchase at the wholesaler's warehouse in his own truck and used his own workers to unload it.

That is a practice called retail hauling. It has absolutely nothing to do with exclusive territories or the bill before this subcommittee. In fact, it is a practice which is prohibited in Indiana today, except in emergencies, and, as I understand it, in many other States.

Since the adoption of the Indiana regulation in 1978, there has been a dramatic decline in the number of beer wholesalers able to make a go of it in the State. At the time of the regulation, there were over 220 active businesses as independent beer wholesalers. Today, the number has shrunk to about 100, and I cannot give you the exact amount because I do not know how many went out of business today.

I would like to answer Attorney General Abrams' comments on the retail beer prices just to the extent that I can give you specific examples where I sell beer to an account who has more than one retail outlet for the same price and he will sell the beer at retail to the consumer at different prices, depending on what the traffic will bear.

One specific example is an account who has a blue collar bar where he has people come in after work for a shot and a beer. He will charge a dollar for a beer. Three blocks away, after nine o'clock, he has what we might call a yuppie bar where they drink Corona and they drink Michelob, et cetera, et cetera, and he will charge $3.75 for the same bottle of beer and think nothing of it. My cost to him is the same, so the cost to the consumer virtually has nothing to do with the wholesale price in many instances.

Another thing that I would like to address is people are talking about the lawsuits and they say these lawsuits are necessary. I happened to be one of the unglorious defendants in a lawsuit that was supposedly the largest antitrust suit ever filed in Federal court.

I happened to be a defendant because my name was in a directory. There were 300 defendant companies and officers that were sued for $100 million with treble charges for supposedly a horizontal-pricing and territory-fixing conspiracy.

The trial took over 5 years. Many of the defendants died during that time. The cost to us as wholesalers was well in excess of half a million dollars in legal costs alone, not including the time on the other side, and no one was found guilty. The mental anguish that this caused me personally is just—I cannot even tell you.

The third thing that I would like to address is the fact that they say if you enact S. 567 it is going to reduce competition. Gentlemen, in 1980 I was primarily an Anheuser-Busch wholesaler in South Bend, Indiana. I sold the Anheuser-Busch products.

Today, in 1987, I sell over 35 brands of beer, approximately 156 different packages, and you ask why. Because there were six wholesalers in South Bend, Indiana, in 1980 and today I am the only one left.

Now, if you want to talk about what transshipping will do, it is going to make the mean get meaner and there will be few survivors. Some day there will be probably half as many wholesalers in Indiana as there are today, and the reason I am testifying is because I do not want to see this happen in other States.

Thank you very much.

[Prepared statement follows:]

TESTIMONY OF MATTHEW R. DEE

PRESIDENT, UNITED BEVERAGE CO. OF SOUTH BEND, INC.

AND

TREASURER, NATIONAL BEER WHOLESALERS' ASSOCIATION

Mr. Chairman, I appear here today in two capacities: first, as an Indiana beer wholesaler who can speak with first-hand knowledge about the consequences of my state's prohibition against exclusive territories; and, second, as an officer and spokesman for the 1,800-member National Beer Wholesalers Association.

A couple of weeks ago, one of our association members sent me a copy of a letter he had received from his Congressman. That Congressman was expressing reservations about the bill before this subcommittee because he wasn't sure it was in the interest of consumers. He said he had heard that there was a 20 percent decline in beer prices after Indiana issued its regulation barring exclusive territories.

Mark Twain wrote that "A lie can get half way around the world before truth can get its shoes on." Amen. In this case, the tall tale of the so-called "Indiana study" appears to be starting its second orbit.

Mr. Chairman, almost from the day this phantom Indiana study made its appearance on the public record, there has been definitive, authoritative and conclusive testimony that no such study ever existed. According to the Congressional testimony of then Indiana Attorney General Lynly Pearson in 1983, the whole thing was a fiction spawned by a misinterpreted remark that a retailer could save as much as 20 per cent on his cost of beer if he picked up the purchase at the wholesaler's warehouse in his own trucks and used his own workers to unload it. That is a practice called "retail hauling." It has absolutely nothing to do with exclusive territories or the bill before this subcommittee. In fact, it is a practice which is prohibited in Indiana today except in emergencies and, as I understand it, in most other states.

Let me give you another fact, and the subcommittee will be hearing more about it from another witness. Far from declining, retail beer prices in Indiana today are higher than the average prices in states which allow exclusive territories. Higher, not lower.

Here is yet another fact. Since the adoption of the Indiana regulation in 1978, there has been a dramatic decline in the number of beer wholesalers able to make a go of it in the state. At the time of the regulation, there were over 220 independent beer wholesalers. Today, that number has shrunk to about 100.

Now, there is nothing in S.567 which would change the situation in Indiana or force any other state to alter its laws. We believe that is a matter properly left to the states. It is not the proponents, but the opponents of this bill who are saying that if the states want to take care of their wholesalers' problem, then let them change their state laws and require exclusive territories the way Ohio and South Carolina and New Hampshire and Pennsylvania do.

Believe me, as a wholesaler who is trying to make a go of it in Indiana, that is a tempting proposition. But, fundamentally it is wrong.

The problem we have today was created by the federal government, and we believe it is the federal government's responsibility to remedy it in a way that respects states' rights as set out in the 21st Amendment. When the Supreme Court held in its 1977 Sylvania decision that exclusive territories were not per se violations of antitrust law, but instead, had to be considered case-by-case under a rule of reason, our problems began.

The rule of reason sounds like a fair, indeed a reasonable approach to the question. But, in practice, the rule of reason turns out not to be a very reasonable rule. It is not reasonable, in my opinion, to expose some beer wholesalers to unlimited litigation in which they are required essentially to prove their innocence of any antitrust violation. These trials can take months, even years to resolve and, in the meantime, they leave the wholesaler hanging out to dry until a verdict is in. He can't take action against another wholesaler poaching in his territory, because he doesn't want to compound his legal problem. It does no good for him to complain that a wholesaler who is doing exactly the same thing a few miles away in an adjoining, "exclusive territory" state is not subject to this rule-of-reason proceeding, but is absolutely immune. He is stuck with the legal bills, the disruption of his business and the mental anguish which attend rule-of-reason trials. That is the system we have today. And, that is the problem which S.567 addresses.

Mr. Chairman, putting the question of appropriate remedy aside, I believe the Indiana experience -- higher retail prices and fewer wholesalers -- can lend some perspective to this discussion.

There is a simple reason why Indiana has not turned out to be the great proving ground for the opponents' contention that exclusive territories mean higher prices and elimination of those arrangements would automatically mean lower prices. It is the same reason why there is no credible evidence from any other state that links exclusive territories to higher consumer prices.

That reason, Mr. Chairman, is that the beer wholesaler has only a small role, a very small role, in the setting of beer prices. The wholesalers' leverage in this matter, such as it is, is heavily outweighed by the combined influence of other participants in the price decision and the hotly-competitive environment in which it all takes place. Far and away the most important factor is the price set by the brewers for their product. Second, is the price that the retailer decides to charge and that can vary widely even within the same territory. Finally, before you even get to the wholesaler's part, there is the weight of government which adds a layer of excise taxes to the price and skewers the whole transaction with another layer of regulatory requirements such as Ohio's minimum 25 percent retail markup law.

In this complex marketing chain, the wholesaler is really a minor player. He is under constant pressure from his supplier to hold down margins in the interest of increasing the brewer's market share. At the retail end, he is faced with fierce competition for shelf space against two dozen or more domestic and foreign beers, to say nothing of substitute beverages like wine, wine coolers and soft drinks.

The suggestion that exclusive territories somehow are a significant factor in this price competition is simplistic, and just plain wrong.

Exclusive territories do one thing and one thing only. They assure that a wholesaler has a potential market large enough to justify his sizeable investment in such things as a warehouse, refrigeration equipment, trucks and a skilled work force. But it is a potential market only. What a wholesaler does in that market depends entirely on how hard he works to meet the competition from other wholesalers in the same market area. And, in that competition, price is the decisive and driving factor.

In past debates on this bill, there have been allusions to so-called "beer barons," out to fatten their profits at the expense of consumers. I don't know, and I question whether those who use this kind of argument know, what they are talking about.

Maybe it's a good debating tactic, but, in my opinion, it amounts to a smear of the hard-working, independent business people who make up our ranks. Let me tell you something about the average beer wholesaler in this country.

According to a 1987 survey of the independent Beverage Marketing Corporation, there are 3,991 beer wholesalers doing business today, ranging from a low of 5 in the state of Delaware to 404 in Pennsylvania.

As in any business, we have a few wholesalers who are highly successful. We have many more who qualify as mom and pop operations. But, the average beer wholesaler may be profiled as follows:

-- Gross Sales -- from $3 to $5 millions

-- Number of trucks -- from 5 to 9

-- Number of employees -- from 10 to 20

In short, Mr. Chairman, the average beer wholesaler is about the same size as the average grocery store operator or new car dealership which you would find in any American city. I would like to ask that this Beverage Marketing Corporation report be made part of this hearing record, so that the next time someone wants to talk about "beer barons" he can be made to answer to the facts of the matter.

I would like to conclude my statement with one last observation.

The question is asked, "Why do beer wholesalers need this bill?" I have talked already about the cost of litigation and the unfairness of subjecting some wholesalers to these kind of suits, while others enjoy total immunity. I think that is reason enough for enacting this legislation. But, there is one other important consideration I want to share with you.

Beer wholesalers are independent business people. They owe that independence to the laws or regulations of the 50 states which mandate a three-tier system for the marketing of beer. Brewers are forbidden to make direct sales to retailers. Hence, the need for a second marketing tier -- the wholesaler.

The wholesaler's relationship with a brewer is strictly contractual. In exchange for the exclusive right to market the brewer's product in a given territory, the wholesaler undertakes the obligation to service all retail outlets in his area regardless of size, to promote and advertise the brand, to rotate stock for assured freshness, to refrigerate inventory especially draft beer, to maintain and repair equipment and to replace any stale product at no cost to the retailer.

In general, it is a good relationship. But, the wholesaler is totally dependent on the brewer to enforce his exclusive rights to market the brand within his territory. If another wholesaler should begin selling the same brand in his area, he can't call a policeman. He has to rely on his brewer to correct the problem.

Unfortunately, so long as there exists the threat of antitrust litigation which falls on wholesaler and suppliers alike, brewers have been reluctant to enforce exclusive territory arrangements against transshippers. That leaves the wholesaler stuck with his contractual obligations but minus the principal benefit for which he bargained. Passage of S.567 would go a long way toward resolving that problem.

I appreciate the Subcommittee's giving me this opportunity to testify and I would be happy to answer any questions.

APPENDIX 8

BEVERAGE
MARKETING

March 9, 1987

Mr. Frank McNierney
National Beer Wholesalers Association
5205 Leesburg Pike #505
Falls Creek, VA 22041

Dear Frank:

Enclosed are the charts we discussed on Friday. Please bear in mind that these are preliminary top line data sorts from our 1986 national beer wholesaler sales survey. The preliminary data would slightly over-state sales, employees, and delivery truck fleet sizes.

The 1986 survey data indicate there were 3,991 wholesalers. The average beer wholesaler may be profiled as follows:

-Sales: $3-$5 Million
-Truck Fleet Range: 5-9
-Employee Range: 10-20

If you have any questions, please don't hesitate to call.

Best regards,

Michael C. Bellas
President

MCB/tlt
Enclosures

1986 NATIONAL BEER DISTRIBUTOR DEMOGRAPHICS BY STATE

STATE	NUMBER OF ESTABLISHMENTS
ALABAMA	56
ALASKA	9
ARIZONA	54
ARKANSAS	51
CALIFORNIA	254
COLORADO	60
CONNECTICUT	22
DELAWARE	5
DISTRICT OF COLUMBIA	10
FLORIDA	97
GEORGIA	74
HAWAII	18
IDAHO	36
ILLINOIS	196
* INDIANA	122
IOWA	80
KANSAS	60
KENTUCKY	66
LOUISIANA	77
MAINE	16
MARYLAND	55
MASSACHUSETTS	42
MICHIGAN	165
MINNESOTA	117
MISSISSIPPI	57

NOTE: Most recent available data indicates slightly over 100 beer wholesalers in the state of Indiana.

MISSOURI	92
MONTANA	45
NEBRASKA	50
NEVADA	23
NEW HAMPSHIRE	17
NEW JERSEY	47
NEW MEXICO	30
NEW YORK	162
NORTH CAROLINA	94
NORTH DAKOTA	29
OHIO	146
OKLAHOMA	57
OREGON	89
PENNSYLVANIA	404
RHODE ISLAND	10
SOUTH CAROLINA	59
SOUTH DAKOTA	29
TENNESSEE	46
TEXAS	286
UTAH	19
VERMONT	12
VIRGINIA	78
WASHINGTON	100
WEST VIRGINIA	62
WISCONSIN	173
WYOMING	33
TOTAL	3991

Source: Beverage Marketing Corporation, 1987

1986 NATIONAL BEER DISTRIBUTOR DEMOGRAPHICS

I - SALES (P)

Size of Establishment	Number of Establishments	Percent of Total	Cumulative Percent of Total
$50 Million or More	43	1.08%	1.08%
$25 to $50 Million	170	4.26	5.34
$10 to $25 Million	500	12.53	17.87
$5 to $10 Million	659	16.51	34.38
$3 to $5 Million	648	16.24	50.62
$2 to $3 Million	587	14.71	65.33
$1 to $2 Million	749	18.77	84.10
Under $1 Million*	635	15.90	100.00
TOTAL	3991	100.00%	

(P) Preliminary Top Line Sales Data; Includes distributor wine & spirit sales; March 7, 1987

* Includes 5 unclassified companies

Source: Beverage Marketing Corporation; New York, NY

1986 NATIONAL BEER DISTRIBUTOR DEMOGRAPHICS

II - TRUCK FLEET RANGES (P)

Size of Fleet	Number of Establishments	Percent of Total	Cumulative Percent of Total
100 or more Trucks	6	0.15%	0.15%
50 to 100 Trucks	59	1.48	1.63
20 to 50 Trucks	415	10.40	12.03
10 to 20 Trucks	865	21.67	33.70
5 to 10 Trucks	1430	35.83	69.53
1 to 5 Trucks*	1216	30.47	100.00
TOTAL	3991	100.00%	

(P) Preliminary Top Line Truck Data; March 7, 1987

* Includes 6 unclassified companies

Source: Beverage Marketing Corporation; New York, NY

1986 NATIONAL BEER DISTRIBUTOR DEMOGRAPHICS

III - EMPLOYEE RANGES (P)

Employee Range	Number of Establishments	Percent of Total	Cumulative Percent of Total
100 or more Employees	144	3.61%	3.61%
50 to 100 Employees	453	11.35	14.96
20 to 50 Employees	942	23.60	38.56
10 to 20 Employees	1089	27.29	65.85
5 to 10 Employees	866	21.70	87.55
1 to 5 Employees*	497	12.45	100.00
TOTAL	3991	100.00%	

(P) Preliminary Top Line Employee Data; March 7, 1987

* Includes 3 unclassified companies

Source: Beverage Marketing Corporation; New York, NY

Senator DECONCINI. Mr. Dee, thank you very much.

Mr. Henry.

Mr. HENRY. Thank you. My name is Michael Henry. Together with my wife, we operate the California Fruit Market in Rutland, Vermont. I am also here today representing the Vermont Retail Grocers Association. For the record, our store is 3,500 square feet and we employ 17 people.

Today, I would like to emphasize the value which small retail grocers place upon exclusive territories for the distribution of malt beverages. Mr. Chairman, most of our members are small, independent grocers located in small villages and towns across Vermont.

These establishments, many of them mom-and-pop operations in the truest sense of the word, could not justify the services rendered by our beer wholesalers were it not required by the franchise agreement between brewer and wholesaler, which requires the wholesaler to service all retailers regardless of size or location within that given territory.

If the true cost of servicing these small retailers were reflected in the retail price, beer sales would plummet and our level of business activity, our very livelihood, would certainly be jeopardized.

I have carefully reviewed the testimony presented by opponents of this bill. I do not pretend to be a lawyer. Yet, it seems clear that lawyers object to the bill because it provides a simple test to replace the present rule of reason.

As I read their objections, they seemed to prefer a standard that almost certainly guarantees extensive litigation. In a small State like Vermont, we do not have the financial resources for extensive litigation against the big national and multi-national corporations.

The objection by others purporting to speak for small business and the consumer leads me to wonder what planet they live on. Every assertion about the evils of exclusive territories has been refuted. Prices on beer have not risen any faster than any other commodity, and in several cases the prices trail many items.

My customers are hard-working, frugal New Englanders. They appreciate fresh product and being able to take advantage of discounted brands. As I said before, if beer wholesalers did not have the requirement to service all retailers, large and small, at non-discriminatory prices, our smallest stores would suffer.

Furthermore, it would chill competition if the large chains were to monopolize the retail sale of beer. In Vermont, when it comes to beer, whether it is a large store or a small store, an independent store or a chain store, we all compete on the same basis. Leave it that way. Let the States decide.

Our legislature enacted an exclusive franchise law in 1975 to regulate the three-tier system for beer. That law has worked extremely well and Vermont retail grocers would like to see our Vermont law reinforced by federal law.

Mr. Chairman, my organization was privileged to appear before this committee in May of 1985. Our testimony today is intended to reinforce that 1985 testimony. S. 567 is a good bill, and I have to emphasize it is good for small business and it deserves prompt enactment.

I would like to just make one other comment with regard to the testimony by our neighbors to the west. Attorney General Abrams indicated the retail price of beer increased dramatically since exclusive territories were established. I think one of the things that he failed to mention was that New York State during that period of time enacted the container law, which automatically added probably 30 cents to each six-pack of beer.

Thank you.

[Prepared statement follows:]

Hearings, Senate Subcommittee on
Antitrust and Monopolies, August 4, 1987.

TESTIMONY OF MICHAEL J. HENRY

PRESIDENT, CALIFORNIA FRUIT MARKET INC.

RUTLAND, VERMONT

REPRESENTING

VERMONT RETAIL GROCERS ASSOCIATION

Mr. Chairman and members of the Subcommittee, thank you for the opportunity to appear here today. Today, I would like to emphasize the value which small retail grocers place upon exclusive territories for the distribution of malt beverages.

Mr. Chairman, most of our members are small independent grocers located in small villages and towns across Vermont. These establishments - many of which are mom & pop operations in the truest sense - could not justify the services rendered by beer wholesalers were it not required by the franchise agreement between brewer and wholesaler which requires the wholesaler to service all retailers regardless of size or location within that territory. If the true cost of servicing these small retailers were reflected in the retail price, beer sales would plummet and our level of business activity - our very livelihood - would be in jeopardy.

I have carefully reviewed testimony presented by opponents of this bill. Now, I'm not a lawyer. Yet it seems clear that lawyers object to the bill because it provides a simple test to replace the present "Rule of Reason." As I read their objections, they seem to prefer a standard that almost guarantees extensive litigation. In a small state like Vermont, we just do not have the financial resources for extensive litigation with the big national and multinational corporations.

The objection by others purporting to speak for small businesses and the consumer leads me to wonder what planet they live on. Every assertion about the evils of exclusive territories has been refuted. Prices of beer have not risen any faster than other commodities, and in several cases the price rise trails many items. My customers are hard working, frugal New Englanders. They appreciate fresh products and being able to take advantage of specials on different brands. I have tasted stale beer, Mr. Chairman, and I can assure you that my customers would be outraged if they happened to get any. Word travels fast in a small town, and my business would be sorely damaged.

As I said before, if beer wholesalers did not have the requirement to service all retailers - large and small, at non-discriminatory prices, our smaller stores would suffer. Furthermore, it would chill competition if the large chains were to monopolize the retail sales of beer. In Vermont, when it comes to beer whether its a small store or large store, an independent or a chain operation, we all compete on the same basis. Leave it that way.

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Thank you very much.

Senator DECONCINI. Mr. Henry, thank you very much. I will proceed with some questions.

Mr. Lees, how many brands of beer do you sell in your establishment?

Mr. LEES. Approximately 20.

Senator DECONCINI. And how would you characterize competition among those brands? Would you say it is high or very competitive?

Mr. LEES. Not really. We have two or three dominant brands that are the pacesetters.

Senator DECONCINI. Are some of them very competitive?

Mr. LEES. No, not really.

Senator DECONCINI. None of them?

Mr. LEES. I do not feel they are competitive, no, sir. I feel that there are two or three dominant brands and they pretty much have taken over the market.

Senator DECONCINI. And they are not competitive among each other?

Mr. LEES. Not really.

Senator DECONCINI. I think you state, and correct me if I am wrong, that your customers buy in accordance to price competition. Is that what your statement was?

Mr. LEES. That is correct.

Senator DECONCINI. Do your customers tend to buy according to a price competition more than a loyalty to a particular product?

Mr. LEES. That has happened over the period of the last few years in the food industry, whether it be coffee or whether it be beer or anything else. However, I would like to interject that the three major brands that dominate the market in my particular unit are all priced the same.

Senator DECONCINI. They are all priced the same?

Mr. LEES. They are all priced the same. There is no competitive pricing.

Senator DECONCINI. And how long has that been that there has been no competitive pricing, a year, 2 years, 5 years?

Mr. LEES. That has been ever since I have been in it, which is probably about 10 years.

Senator DECONCINI. They are always exactly the same?

Mr. LEES. They are not all exactly always the same, no, sir. I am sorry if I gave that impression. In Massachusetts, they have what they call a post-off, which is a discount, and it may be a dollar per case on a pallet of beer, which would be 99 cases in our particular instance.

Maybe one particular brand would have a post-off this month, the next brand would have a post-off the next month, the next brand would have a post-off the following month.

Senator DECONCINI. But no one is trying to sell you more of their beer by offering——

Mr. LEES. By offering a discount on a regular basis? No, sir.

Senator DECONCINI. Mr. Lees, if I were to tell you that the price of beer would remain the same or it would decline, that the service provided to you regarding malt beverage products would remain the same or increase, that excessive litigation could be avoided, that competition would remain present and strong, and that States would not be prohibited from enacting legislation in the area, would you remain opposed to this legislation?

Mr. LEES. I am opposed to any legislation of this type. I am also opposed, quite frankly, to the soft drink legislation.

Senator DECONCINI. Did you oppose that legislation?

Mr. LEES. No, sir. Quite frankly, I was not aware of it at the time. If I had an opportunity——

Senator DECONCINI. You would have?

Mr. LEES. If I had an opportunity to come back—if you want to sponsor a bill repealing that, I would be more than glad to come back and testify for you.

Senator DECONCINI. Then we will put you on Senator Metzenbaum's future list of witnesses, Mr. Lees. [Laughter.]

Mr. LEES. Great.

Senator DECONCINI. Thank you.

Mr. Dee, why, in your opinion, if you can go into a little more detail, has not mandatory, non-exclusive territories in Indiana resulted in lower prices? We hear the argument of how that is really going to bring down the prices. Why has it not done that?

Mr. DEE. I want to make sure I say this right, Senator, and I do not want to offend anyone, but I guess the price to consumers is not dictated by the wholesaler; it is dictated by the retailer.

Now, to be very honest, when transshipping began and prices declined at the wholesale level in an effort for certain transshippers to gain business in large markets, the price did decline to the retailer.

However, the retailer seemed to take those added margins that he was gaining and rather than passing it on to the consumer, he passed it on, excuse me, to the Lincoln dealer or the Porsche dealer for his own benefit, and this went on for many years. The fact was that the price to the consumer did not change.

Senator DECONCINI. Yes. What you are saying is the argument that if you do not have any exclusive territories, like your State, and that people from different States can bring in liquor on a wholesale basis, at least the experience in Indiana is the price does not end up in the consumer's benefit?

Mr. DEE. That is correct. All I have heard is people saying, well, the poor consumer, the poor consumer. The poor consumer is not going to benefit anyway.

Senator DECONCINI. If you were a retailer, why would you not lower the price of your beer or your Pepsi Cola or something if, in fact, you could buy it cheaper from a transshipper than you could buy it from you? Is it because the demand is so great?

Mr. DEE. Let me put it this way, and to be very honest and to go along with what Mr. Lees says, Anheuser-Busch and the Miller Brewing Company spend millions of dollars advertising their products and, let us face it, the people today have been raised by the boob tube.

When people become of drinking age, they go out and they drink what they see on television; they drink what their peers drink. Other than people who are on fixed incomes, you know, if they are Budweiser drinkers or if they are Miller Lite drinkers, that is what they are going to drink.

Senator DECONCINI. So price is not really going to make that much difference to them?

Mr. DEE. I think if they can buy Miller Lite a dollar a case cheaper tomorrow than they could buy it today, they might buy, you know, two cases instead of one, but when the price goes back up, they have still got it.

Senator DECONCINI. What is the average size of wholesalers?

Mr. DEE. You mean beer barons, sir?

Senator DECONCINI. Yes, sir.

Mr. DEE. I testified some years back that if I was a beer baron, I wondered where my fiefdom was. The normal beer baron in the United States—and this is an average because I did some——.

Senator DECONCINI. When you are referring to beer baron, you mean wholesalers?

Mr. DEE. Yes, sir.

Senator DECONCINI. Yes, sir.

Mr. DEE. I think the only beer baron left, probably, is Gussy Busch, Sr., who is 80-some years old; he is probably a beer baron. But beer wholesalers in the United States are very small businessmen in relationship to other businesses.

The average beer wholesaler does between $3 and $5 million annually. Chances are he has got members of his family working in the business. He operates five to nine trucks as an average, and probably has about 15 employees. Now, there are some that are smaller than that and some that are larger, but that would be an average.

There is a chart that we had prepared by NBWA staff that shows that in regards to wholesale grocery distribution, local department stores and car dealers, we are, in fact, smaller in dollar volume and number of employees employed.

Senator DECONCINI. So many wholesalers would be smaller than Mr. Lees' operation of 60-some employees?

Mr. DEE. Well, he has stated his warehouse was 33,000 square feet; mine is 31.

Senator DECONCINI. And he has 68 employees.

Mr. DEE. And I have 35.

Senator DECONCINI. You have 35?

Mr. DEE. Yes, and some are part-time college students.

Senator DECONCINI. When you made reference to the Busch family, really, they are not wholesalers, are they?

Mr. DEE. No, sir.

Senator DECONCINI. They are the manufacturers or the distillers.

Mr. DEE. That is correct.

Senator DECONCINI. If the legislation is passed that is before us, do you believe that wholesalers, as opponents argue, will be able to raise prices?

Mr. DEE. No, sir, I do not, not at all.

Senator DECONCINI. And that is based on your experience as a wholesaler?

Mr. DEE. That is based on competition. You know, realistically, that is based on competition because the Miller wholesaler is not going to raise the price of Miller because he knows the Budweiser wholesaler is going to take his business, and vice versa.

Senator DECONCINI. Yes.

Mr. Dee. So they are going to be competitive in the marketplace. These brewers are spending too much money to allow their wholesaler to lose a share of business. It is as simple as that.

Senator DeConcini. Mr. Dee, thank you.

Mr. Henry, I have some more questions I would like to ask, but time has a way of getting away from us here. What would happen in your State if you did not have the exclusive territories?

Mr. Henry. I think that there would be many small retail establishments that just would not be serviced because the wholesaler could not afford to service the account.

Senator DeConcini. Do you attribute their existence and continued existence to the fact that there are exclusive territories?

Mr. Henry. The wholesaler must service every account.

Senator DeConcini. They cannot deny you?

Mr. Henry. That is right. We have an instance in Plymouth, Vermont, the birthplace of President Calvin Coolidge. There is a small store there that services that small community about five miles off the beaten path. They have no problem getting service for beer, but they do have problems getting service for bread and milk and other things.

Senator DeConcini. Just because nobody wants to travel that far?

Mr. Henry. It is 5 miles off the beaten path and nobody wants to go that 5 miles, and I think that illustrates the problem. When they are not forced to service these accounts or beer comes out of the chair store warehouse or we have transshipping, the small guys are going to be left behind.

I think the Vermont beer people estimate that something like 60 percent of the beer volume in Vermont is sold not in the chain stores, but in the small mom-and-pop stores, et cetera.

Senator DeConcini. Mr. Henry, opponents of this legislation have asserted that consumers of malt beverage products are blindly loyal to a particular brand of beer and that exclusive territories allow for the manipulation of prices within a given brand.

Is that your experience, or are consumers more discriminating in seeking out good prices for the malt beverages they purchase?

Mr. Henry. Well, number one, I would certainly disagree that they are blindly loyal. In 10 years, we have seen people switch from Schlitz, which is almost non-existent in Vermont, and then over the years you see the increase and the decrease in Budweiser and Miller and Coors and other beers like that. So it is not that they are blindly loyal.

Senator DeConcini. And that tells you that that is competition that is making those switches?

Mr. Henry. That is right, and if we compare to the soft drink industry, Coke and Pepsi in our community are fiercely competitive and there is no way that either company wants the other to get any type of competitive advantage and they fight like cats and dogs.

Senator DeConcini. This is in the soft drink industry?

Mr. Henry. Yes, the soft drink industry, and I think you certainly find it in the beer industry.

Senator **DeConcini**. Is it your belief or experience in the soft drink industry that that competition has kept the prices level or not rising as fast as other commodities that you sell?

Mr. **Henry**. I think the prices in soft drinks are flat; they are down.

Senator **DeConcini**. Mr. Henry, you stated that in 1975 when your State enacted the exclusive territory law—did you see prices rise after the enactment of that law?

Mr. **Henry**. Not really.

Senator **DeConcini**. What has been your experience with exclusive territories since 1975?

Mr. **Henry**. Well, I think that most importantly, a wholesaler, before he offers a discount on a product, he has to post that discount with the State liquor control board, and he has to post that discount ten days before it is effective and it is only effective for a given period of time.

Every retailer in Vermont is entitled to purchase that post-off at that given price regardless of whether he is buying 1, 2, 10 or 100 cases. Everybody competes on the same basis. You do not find the big guy getting a lot of product cheaper and impacting the smaller retailer.

Senator **DeConcini**. At this time in the record I want to insert a letter from the Kerr Companies of Athens, Ohio, and Mr. Kenneth Kerr, Chairman-Elect of the National Beer Wholesalers Association. So without objection, that will appear in the record.

[The following was received for the record:]

KERR

KERR COMPANIES
P. O. Box 803
Athens, Ohio 45701
(614) 593-3353

July 29, 1987

Senator Howard H. Metzenbaum
Chairman, Subcommittee on Antitrust,
Monopolies and Business Rights
Russell Senate Office Building
Room 140
Washington, D.C. 20510

Dear Chairman:

I am writing this letter as Chairman-elect of the National Beer Wholesalers Association representing the Ohio beer wholesalers and the many beer wholesalers around the country.

The nation's beer distributors again are asking Congress for a modicum of relief from costly and unnecessary antitrust law suits. Even though Ohio beer wholesalers are not directly affected by the provisions of S.567, they nevertheless strongly support the measure out of a sense of what is fair to their fellow wholesalers in other states. I should note as well that this clarification of federal law would be comforting insurance against any future change in state law and regulations.

Opponents of S.567 make three basic arguments against the legislation:

1. It would give beer distributors a special exemption from the antitrust laws which other businesses do not enjoy.
2. By shielding exclusive territories from antitrust challenge, the bill would result in higher beer prices.
3. A federal law is unnecessary because the states already have the power to shield their beer wholesalers from antitrust suits by adopting state laws mandating exclusive territories.

I would like to respond briefly to those three points because I do not believe any one of them can withstand factual examination.

1. The Malt Beverage Bill is modeled precisely on the legislation

☐ **Kerr Distributing Co., Inc., Athens Division, 771 W. Union St., Athens, Ohio 45701**
☐ **Kerr Distributing Co., Inc., Portsmouth-Ironton Division, Old Rt. 52, Franklin Furnace, Ohio 45629**
☐ **Kerr Wholesale Co., 505 E. Seventh St., Chillicothe, Ohio 45601**
☐ **Kerr Beverage Co., 1115 Milan Ave., Amherst, Ohio 44001**
☐ **RKK Distributing Co., Inc., 1138 Lexington Ave., Lorain, Ohio 44052**

which Congress passed in 1980 to give limited antitrust relief to soft drink distributors. So, it is not unprecedented, special legislation. Nor does it provide an "exemption" from antitrust laws. The bill merely establishes a threshold for when a court will consider antitrust cases under the existing rule of reason standard. Specifically, the bill says that whenever there is "substantial" and "effective" competition among brands within a marketing territory there is no basis for an antitrust case on the grounds of exclusive territories.

In fact, the Malt Beverage bill provides far less antitrust relief than is presently enjoyed by wholesalers in the 27 states which today mandate by law that beer be distributed only through exclusive territories. (The state of Ohio is one of those.) The reason for this is the doctrine of state action immunity which holds that an individual who is forced to comply with state law cannot be held liable for a federal violation if there is no preemptive federal statute. There is no such federal statute in the case of exclusive territories. In short, wholesalers in those 27 states do not even have to meet the test of effective and substantial interbrand competition as I understand it.

What that leaves is a double antitrust standard wherein wholesalers in 27 states are absolutely exempt while wholesalers in the 22 states which permit (but do not require) exclusive territories are left to take their chances under lengthy and costly rule-of-reason proceedings.

Congress saw fit to grant relief to the soft drink industry which employs a distribution system similar to ours. But, soft drinks were never burdened by the double standard faced by beer wholesalers, nor do they have state laws dictating precise distribution systems. There are differences between the two industries, to be sure, but on the issue of exclusive territories and antitrust liability, I believe beer wholesalers have an even stronger case for relief.

2. The charge that exclusive territories will mean higher consumer prices does not square with the experience of states that have mandated such arrangements for years. Michigan is a case in point. It adopted an exclusive territory system in January 1977. In the year before that system was implemented, the real price (1967 dollars) of a six pack in the state averaged $1.04. Seven years later, the price was down to 91 cents a six pack. This was the finding of the Michigan Public Health Service which was advocating an increased excise tax on beer. A similar finding was made in Alabama where prices declined after adoption of exclusive territories, while nationwide prices increased.

To my knowledge, no similar price survey has been done of Ohio's beer wholesale prices, but I am absolutely confident that any such study would yield the same results as elsewhere in the country.

Finally, a Bureau of Labor Statistics review of price increases for common consumer goods shows beer prices far below those of meat, bread and even milk for most of the 20-year survey period. This is hardly consistent with the opponents' allegation of higher beer prices, when it is considered that exclusive territories, whether required by law or merely permitted, are the prevailing distribution system around the country.

3. Contradictory as it is, opponents continue to claim simultaneously that a) the bill would be a dangerous precedent and b) that it isn't needed because states already have the power to confer antitrust immunity on their beer distributors. I wish to make only one point on the states rights argument. It is true that states can immunize wholesalers from antitrust suits based on exclusive territories by simply adopting a state law requiring distribution through such a territorial system. But what of the right of states which choose not to do that and instead opt for a mixed system, one in which it is perfectly legal to have exclusive territories but also legal to distribute in other ways?

   If states rights is the issue, why should the 22 states which have chosen a mixed system suffer exposure to certain federal antitrust suits while others do not? Why should these states have to do things the way we do it in Ohio to escape federal harassment? Why should there be a double standard in federal antitrust law at all? If states rights means anything, it surely means the right to do things as the state itself determines to be in its citizens' best interests.

I hope you will find this statement helpful in understanding the justification for the modest clarification of antitrust law which S.567 provides. I would request that it be made part of the official hearing record.

Best Regards,

R Kenneth Kerr

R. Kenneth Kerr
Chairman-elect,
National Beer Wholesalers Association

Senator DECONCINI. Mr. Lees, in your experience as a retail promoter and seller, do you select items that you promote yourself regardless of what the price is that you might get from the wholesaler?

Mr. LEES. Yes, sir, I do.

Senator DECONCINI. Have you done that with beer? Have you ever selected one beer, or do you do that and push that one?

Mr. LEES. Whatever the popular product is at any given point in time. I think that there has been too much made about price relationship to popularity of beer. Beer is purchased by the consumer, especially the younger consumer, based on the popularity of the product, whatever is the in drink this particular season, and it can change, whether it be beer or whether it be any other type of alcoholic beverage.

The price relationship to the consumer has been bandied around a lot today, and the ultimate deciding factor is competition, I will agree, on the retail level and not the wholesale level.

However, in our State—and I cannot speak for Vermont because I do not know how their laws work, but in our State the exclusive territories work to the detriment of the smaller retailer.

When I started out, I had an 800-square-foot store and it has grown to the size I have grown, but I do know what it is and what it feels like to be a small retailer and not be serviced.

Senator DECONCINI. You do know that?

Mr. LEES. Yes, sir. As I said, I started out with an 800-square-foot store with myself as the only employee.

Now, right now, if you purchase in larger quantities—if you purchase 99 cases, for example, from one particular wholesaler, I can buy it at a much cheaper price. The smaller operator down the street does not even have storage for 99 cases. He pays a higher price. I can retail it for what he is paying for it right now.

Senator DECONCINI. You say that these wholesalers every few months or maybe one every month will have some special and give a discount.

Mr. LEES. Right.

Senator DECONCINI. But it is not competition among each other; it is just as they decide to do it. When you get that advantage, when one of your wholesalers comes in and says here is 99 cases and you get this discount, does that influence you on putting that one on a special on the retail market, then?

Mr. LEES. Yes, sir, I will put it on special.

Senator DECONCINI. Yes.

Mr. LEES. I will notice some increase in sales. I would be lying if I said I did not, but I will not see people change brand loyalty for price, particularly, strictly.

Senator DECONCINI. You do not see the switch?

Mr. LEES. In other words, what I am saying is if you have got a—is it all right to mention brand names?

Senator DECONCINI. Oh, sure.

Mr. LEES. All right. I will not see a person change from Coors to Budweiser if they are a staunch Coors drinker.

Senator DECONCINI. You will not see that?

Mr. LEES. I will not. What they will do is they will wait until—it may be the second or the third month when Coors is on post-off at a cheaper price and they may buy two or three cases to stock up on it. That has been my experience anyway, at least.

Senator DeConcini. So unlike Mr. Henry testified, you do not see the volume go down by the fact that a price is lower or that it goes up if a price is higher?

Mr. Lees. It will change slightly one way or another, but it is not a major shift.

Senator DeConcini. Mr. Lees, thank you. I want to thank you for coming here. Though I am not on the same side of the issue, I appreciate very much your taking the time and being here to give us the insight of small business, as I do with you, Mr. Henry. Quite frankly, Mr. Dee, you seem to be a small businessman yourself. Thank you very much, gentlemen.

We will now go to the last panel, which will be Peter C. Carstensen, Professor, University of Wisconsin Law School, Madison, Wisconsin; Robert D. Tollison, Professor of Economics, and Director of the Center for Study of Public Choice, George Mason University in Virginia; and Richard Willett, partner in the Grant Thornton accounting firm.

Gentlemen, we will submit your entire statements in the record, as we will the past panel, too, which I failed to mention. If you would summarize those, we will have a five-minute rule here.

Mr. Carstensen, if you would like to begin, sir.

STATEMENT OF A PANEL CONSISTING OF PETER C. CARSTENSEN, PROFESSOR OF LAW, UNIVERSITY OF WISCONSIN, MADISON, WI; ROBERT D. TOLLISON, PROFESSOR OF ECONOMICS, GEORGE MASON UNIVERSITY, FAIRFAX, VA; AND RICHARD B. WILLETT, PARTNER, GRANT THORNTON ACCOUNTING FIRM, WASHINGTON, DC

Mr. Carstensen. Thank you very much, Senator. I am professor of law at the University of Wisconsin Law School. A primary focus of my scholarly work has been the legal and economic analysis of restraints of trade.

There are three points I would like to cover in my oral statement here. First, in collaboration with Richard Dahlson, I published an article in the Wisconsin Law Review last year which contained an extensive analysis of territorial restraints in beer distribution. We included a significant review of the testimony in these congressional hearings.

Let me summarize briefly what we think we found. First of all, consistent with what you have heard before, there seemed to be three possible functions for territorial restraints in beer.

They might improve efficiency by dealing with free-rider problems, et cetera. They might facilitate cartelization within the industry at the brewer or at the wholesaler level. Third, they might facilitate geographic price discrimination by brewers.

Now, it is terribly important in terms of what has been said today that you recognize that in each instance the particular purpose of the restraint is to facilitate price increasing by either the wholesaler or by the brewer.

That is, the point in the efficiency argument for the territorial restraint is that the wholesaler does more things. The wholesaler needs to be compensated. The wholesaler is at risk from free riding. The wholesaler, therefore, is protected with a territorial restraint that permits him to raise price.

The cartelization stuff is fairly obvious. The wholesaler raises its price simply to rip off the customer.

The price discrimination model says that the brewer uses the territorial restraints to charge different prices to wholesalers in different territories. So we are raising prices in each instance.

When we looked at the evidence that has been presented, Rick Dahlson and I were surprised to find that there is practically no evidence to support the efficiency theory. There is practically nothing that directly says here are the important things wholesalers are doing.

On the other hand, we found a great deal of evidence that would suggest that a primary function of these restraints, the plea from Mr. Dee here today, is to eliminate competition so that wholesalers can raise their prices.

We also found substantial evidence to suggest that another important function is to facilitate brewer territorial price discrimination, and notice the nice trade-off. The wholesaler gets to raise prices to the customer, gets its rip-off, if you will. The brewer, at the same time, gets to do geographic price discrimination, which would be frustrated by transshipping, and so it, too, is made better off. Both are made better off. The consumer is made worse off, and that was the fundamental conclusion we came to from a review of the evidence in this record.

The second point that I would make to you is two important facts, one of which has been reiterated again and again—I do not know that I need to spend any substantial time on it—which is the brewing industry is subjected to extensive State regulation.

If a State wants exclusive distribution, a State can have exclusive distribution. There is no point in creating an uncontrolled level—that is, authorized at the Federal level and unregulated at the State level—of restraints on distribution.

The second fact is, I think, a very important one. Since the time this legislation began being proposed until now, concentration in the beer industry, despite new entry, has increased dramatically—10 percentage points in the standard concentration measures, 500 points if you use the Herfindahl Index.

The industry has moved nationwide at the brewing level from being marginally concentrated to being quite concentrated. I think that is a significant economic consideration.

My final point is, quite frankly, I am appalled at the level of evidence, if I could dignify it with that term, that is being presented as information in this hearing. Let me try to go to some specifics on this by way of illustration.

Choice of time periods. We know as a fact that all the major brewers, led by Anheuser, went in 1983 to exclusive territories. Yet, Senator DeConcini, the data presented here, including Mr. Willett's work and much of the Tollison testimony, acts as if we can compare States that mandate territorial restraints with States that do not mandate territorial restraints in the post-1983 period. It cannot be done. Territorial restraints existed in both. Of course, you are going to find no difference. It is before 1983 and after 1983 that may be significant.

We also find various kinds of poor choice of variables, it seems to me, to make the arguments. I wish I had more time to elaborate on this because it seems to me that if you want to deal with the economic realities of this industry, you have got to look for better kinds of information than the sort of information that has been presented in this hearing by both sides, I would hasten to add, and in any of the prior hearings.

[Prepared statement follows:]

Statement of

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Before the

Antitrust Subcommittee

of the Judiciary Committee

United States Senate

Concerning

S 567

The Malt Beverage Interbrand Competition Act

August 4, 1987

Mr. Chairman and Members of the Committee

I am pleased to have this opportunity to appear before you to discuss the public policy implications of the proposed Malt Beverage Interbrand Competition Act. In collaboration with Richard Dahlson, I recently published an extensive analysis of territorial restraints in beer distribution which included a detailed review of the contentions made in prior Congressional hearings to justify this proposed legislation.[1] We concluded that neither the public record nor the extrinsic evidence and analysis which we found justified the claim that territorial restraints in general were necessary for efficient distribution of beer. On the other hand, the evidence both within and outside the record did strongly suggest that such restraints might serve various anticompetitive functions. As a result they may well cause consumers to pay higher prices for the benefit of either distributors or brewers. Consequently, we concluded that they were undesirable from the perspective of traditional economic welfare. Nevertheless, we recognized that Congress might wish to grant a subsidy to beer brewers or distributors. However, it was our suggestion that Congress ought to be more overt in adopting such a policy because it is at best a very debatable proposition and, in any event, there are less costly and more efficient ways to provide a subsidy to favored businesses.

In addition, I want to emphasize two facts about the brewing industry which, I think, should make you very skeptical about exempting it from the antitrust laws. First, the distribution of beer is already subject to pervasive state regulation. The states have broad powers and actively use them to regulate all aspects of distribution. This regulation may itself be a major source of any efficiency problems, but such regulatory power also means that the states can decide if distribution is not working well and have the ability to impose whatever solutions are necessary. This makes Congressional action questionable especially when it will create a new layer of private, unsupervised restraints on competition. Second, the beer industry has a highly concentrated structure. It has become noticeably more concentrated over the last six years at both the brewing and wholesaling levels. The central implication of these structural facts is that the risk of seriously anticompetitive consequences from distribution restraints is dramatically increased.

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[1] Carstensen, Dahlson, Vertical Restraints in Beer Distribution: A Study of the Business Justifications for and Legal Analysis of Restricting Competition, 1986 Wisc. L. Rev. 1.

In the following parts of this statement, I will first explain how and why we reached those conclusions. Second, I will discuss those two key economic facts about the brewing industry that, I think, should make you very skeptical about exempting it from the antitrust laws. Third, I would like to explain briefly why I am pessimistic that the antitrust laws as presently being interpreted will provide the kind of critical analysis that ought to be given to these restraints. This leads me, fourth, to the suggestion of a complete redirection of this legislation. However, my own conclusion, and final point, is that industry specific efforts to fix up the antitrust laws are a poor policy choice. Overall it is better either to continue the process of judicial development of our law governing distribution restraints or to consider general legislation to clarify those standards. The factual ambiguities surrounding the functions of territorial restraints in the beer industry forcefully illustrate why any ad hoc congressional action may be inadvisable; moreover if action is to be taken with adequate understanding of the real functions of the restraints at issue, this would require an enormous amount of factual investigation and evaluation beyond anything that this committee is doing or has done.

Before turning to my substantive comments, it may be useful to say a word about my background. I did my undergraduate work at the University of Wisconsin-Madison where I received my BA with honors in 1964. I graduated from Yale Law School in 1968 and received an MA in economics from Yale at the same time. From 1968 to 1973 I was an attorney in the Evaluation Section of the Antitrust Division of the U.S. Justice Department. Since 1973 I have been on the faculty of the University of Wisconsin Law School. A primary focus of my scholarly work over the past 14 years has been the legal and economic analysis of restraints of trade with a particular concern for restraints in distribution. I also have a long standing interest in beer--both as a scholar and as a consumer. No trade organization or other lobbying group has sponsored any of my research work and my testimony today is similarly without such sponsorship.

The Carstensen-Dahlson Study of Territorial Restraints in Beer Distribution

There is a great deal of theorizing about the economic function and effects of restraints on distribution, but there is very little concrete empirical work which tests the various theories to see how well they can explain actual conduct.[2] Richard Dahlson and I felt that the beer industry offered a unique opportunity to examine how well the theories about distribution restraints could explain both the agitation for general protection from the antitrust laws and the adoption by the leading brewers of such restraints. We had the benefit of the various hearings held on this proposed legislation in which the proponents sought to explain the economic purposes and effects of such restraints, and there is a great deal of other public data on the operations of this industry.

We identified three potential functions which distribution restraints might serve. They might improve the efficiency and value of the distribution process by protecting distributors from risks of free riding or other comparable opportunistic conduct which could frustrate economically valuable distributor behavior. Second, they might facilitate cartelization of the industry at the distribution or brewing levels or at both simultaneously. Third, they might facilitate geographic price discrimination by brewers. We then evaluated the hearings and other information to determine how well each of these theories explained the observed pattern of restraints and the proposed legislation.

We had expected to find substantial evidence to support the claim that these restraints were essential to efficient distribution. Consequently, we were surprised that neither the hearing testimony nor our own research efforts produced any strong evidence to support the efficiency theory in a way which would have sufficiently general application to explain either the legislation or the general use of such contracts. The few examples of general risk to which all distributors are exposed on examination turned out to be minor (e.g., the obligation to redeem stale beer turned out to be both trivial and easily solvable by means other than restraints on competition) or not to entail risks for which distribution restraints would be relevant (e.g., to the extent that distributors provided consumer specific services - - a matter itself of some doubt - - those services were not subject to significant risks of free riding).

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[2] I recently surveyed the empirical work on this topic and found that it is remarkably inconclusive in establishing the validity of the theories which postulate that distribution restraints are socially desirable conduct. Carstensen, Legal and Economic Analysis of Distribution Restraints: A Search for Reality or Myth-making? in R. Wills, J. Caswell, J. Culbertson, ed. ISSUES AFTER A CENTURY OF FEDERAL COMPETITION POLICY 79 (1987).

I want to emphasize that we were not denying that the efficiency hypothesis has theoretical validity; what we found was that there was practically no evidence to show that it could explain the pervasive use of territorial restraints in this industry. We could certainly imagine that there could be specific situations in which territorial restraints might well serve the public interest in efficient distribution. For example, the introduction of a new brand or the expansion of an existing brand into a new market area might require the distributor to make product specific investments to develop general market demand which would then be subject to serious free riding risks. An exclusive territorial agreement for a reasonable period of time may be functionally necessary in such a situation to get appropriate distributor effort. Similarly, if the brewer required purchase of specialized, costly, product specific equipment, that might justify restraints on distribution for a limited period of time as a way to insure the distributor that it would not fall victim to opportunistic behavior by the brewer or other distributors. However, although territorial restraints may serve such efficiency needs sometimes, the record so far shows that this is a very unlikely explanation for the general use of such restraints in the beer industry. If the public policy justification for this legislation is only facilitating efficient distribution, then there is no present basis for its adoption.

We also developed and tested two other theories that explain vertical restraints. According to one theory, the function of such restraints is to facilitate cartelistic behavior at the brewer and/or distributor level. I should note that we use the term cartelistic in an expansive way to describe any conduct whose function is exclusively or primarily to raise prices or reduce some other dimension of competition. Second, we postulated that vertical territorial restraints might function primarily to facilitate geographic price discrimination by brewers.

With respect to the cartelization theory, we found that a great deal of the evidence in the record was quite consistent with the hypothesis that the purpose of the legislation and the function of existing restraints is to allow distributors to increase their prices as a result of both brand specific cartels and local market interbrand cartels. The effect of the industry-wide pattern of territorial restraints is to limit very severly who can compete with respect to any particular buyer. Intrabrand competition is completely eliminated. As the retailer in South Dakota learned, if it wanted to have Miller Beer on its shelves it had to deal with only one wholesaler.[3] In addition, the restraints keep any wholesaler from entering a market regardless of the prices and quality of service provided by distributors in that market. These limits on inter-regional competition make it much easier for distributors in any local area to establish and maintain price fixes or other restraints of trade.[4] They face no risk of disruptive entry from distributors outside the market. In addition, even if there is no interbrand cartel, distributors of any particular brand are free to charge the most that they can get for their brand because their retail customers, who need that particular brand, can not turn to alternative suppliers. The basic thrust of the bulk of distributor testimony was that they wanted to charge higher prices and that these restrictive contracts would eliminate the "cherry-pickers" and transshippers who kept them from charging such prices.[5]

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[3] See, Assam Drug Store v. Miller Brewing Co., 798 F.2d 311, 313 (8th Cir. 1986). There have been examples in the past in which wholesalers have used this power to discipline retailers by refusing to sell. When retailers have some option to choose their supplier, this reduces such risks and limits any consequent need for detailed judicial review for all individual refusals to deal.

[4] The article documents the long history of such local market conspiracies in beer distribution. Carstensen, Dahlson, supra note 1, at 43-44, n. 175.

[5] Id. at 43-54.

Moreover, the economic motive for distributors to seek such rights is manifest and entirely understandable from their perspective.[6]

The more difficult question in our judgment was why would brewers want to facilitate such conduct which presumably would adversely affect their total volume. We found several plausible explanations.[7] The most important may be that the brewers in return get a much greater ability to employ geographic price discrimination which means that there is an exchange of anticompetitive options between these levels. In addition, brewers have other economically rational reasons to acquiesce in modest levels of distributor cartelization. Offering a distributor cartelistic profits may be a way to attract a distributor who can move some part of its customers' purchases to the brewer's lines. Once one brewer offers such a cartel option, given the difficulties of creating new distributorships, other brewers may have to respond by offering competitive cartel options. Finally, allowing distributors some cartelistic profit means that existing distributors will have an incentive not to encourage new entry and price competition at either the wholesale or retail level. This will provide some added competitive insulation for the existing firms in the industry.

We also considered the possibility that these restraints were related to an effort to cartelize the brewing level of the industry. If brewers sought to cartelize, vertical distribution restraints can facilitate the policing of cartel discipline and allow participating brewers to deal effectively with the threat possed by non participating, small brewers located around the country.[8] Essentially, territorial limits on distribution can isolate the areas of competition and keep it from spreading and destroying the cartelistic understanding. While the structure of the brewing industry is one in which tacit or overt cartelization at the producer level is plausible (a subject to which I will return), nevertheless, there is no significant evidence of such conduct or such objectives on the part of the brewers. However economically rational such behavior might be, the present levels of distrust and hostility among the major brewers probably precludes their being able to reach any such agreement even if it were lawful.[9] Thus, we found no basis to believe that the major brewers had a present plan to create an industry-wide cartel.

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[6] A recent review of data from New Jersey and Indiana suggests that exclusive territories do indeed increase prices. Jordan, Jaffee, The Use of Exclusive Territories in the Distribution of Beer: Theoretical and Empirical Observations, 32 Antitrust Bull. 137 (1987). Similar results have been reported at various hearings on this legislation. See, Carstensen, Dahlson, supra note 1, at 46-47.

[7] Id. at 42-43.

[8] Id. at 57.

Turning to our final theory, geographic price discrimination, we observed that the major brewers historically and contemporarily engage in such conduct.[10] Basically, to the extent permitted by state law, brewers can and do charge different wholesalers different prices and the price differences are not cost justified.[11] A primary basis for brewer concern with transshipping in fact was that it disrupted such discriminatory pricing patterns. The direct cost of beer represents nearly 80% of the costs of doing business for distributors.[12] If different distributors pay significantly different prices for beer, those getting the benefit of lower prices have a strong incentive to resell in the territory of the distributors subject to higher prices. If, however, the brewer confines each distributor within an exclusive territory, that eliminates the risks of low price beer escaping into high price territories. We suggest that brewer support for territorial restraints has a great deal to do with facilitating such geographic price discrimination. It has very little to do with economic efficiency in distribution.

In general, we were surprised at how weak the evidence was that these restraints had any demonstrable efficiency function and how strong the evidence was that they had anticompetitive functions. Yet our conclusions flow quite directly from the analysis of the claims and evidence presented in the congressional hearings on this legislation. What makes our results surprising is that, as is well known, many academic commentators and several circuit court judges including Judges Posner, Easterbrook and Bork, claim that vertical restraints such as these can only serve efficiency functions. They assert that interbrand competition will make it impossible for the parties to have any other effect. Recently the Eighth Circuit in the Assam Drug Store case adopted the same view as have many of the witnesses supporting this legislation.[13] The majority report of the Judiciary committee on this legislation last year also asserted that interbrand competition insured that no risks of excessive prices existed.

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[9] See, Baker, Bresnahan, The Gains from Merger or Collusion In Product Differentiated Industries, 33 J. Ind. Econ. 427 (1985). This article reports a sophisticated econometric investigation of the current power of the major brewers and the likely competitive effects of combinations or collusion between several pairs of leading brewers. The authors found that as of 1983 major brewers individually had market power, but if any pair could achieve perfect collusion (or combination), the resulting market power would increase substantially. Using 1983 data, the authors calculated that Anhuser-Busch would be the primary gainer in such conspiracies and could collect an extra $105 million in profits if it successfully colluded with only one other brewer. Id. at 441. This potential gain does also suggest that as of 1983 at least no such collusion existed.

[10] Carstensen, Dahlson, supra note 1, at 59-61.

[11] See, Jordan, Jaffee, supra note 6, at 153-154.

[12] Carstensen, Dahlson, supra note 1, at 30-31, n.123.

This claim, first, ignores the potential for using apparently innocent restraints to facilitate tacit anticompetitive understandings. This risk is particularly great in the highly concentrated and regulated context of beer distribution. Second, and more importantly, the claim rests on a fatal contradiction within the economic analysis. For a restraint on the subsequent resale activities of the party whose actions are restrained to have any effect, the product whose sale is being restrained must be sufficiently distinctive that it is relevant to control conduct with respect to its re-sale. Unless Miller Beer is different from Anheuser-Bush beer in the minds of consumers, no Miller distributor will invest special efforts, collect stale beer, or incur any other expense in reliance on an exclusive right to sell Miller Beer. Why? Because the Anheuser-Busch distributor will be able to take a free ride on the Miller distributor's efforts. We have assumed, recall, that customers do not care which beer they get. The Supreme Court in the Sylvania case (following the writings of Judges Bork and Posner) suggested that vertical restraints "may" improve distribution.[14] But if one asks how such restraints function to make such conduct possible, it is obvious that they only do so by allowing the re-seller to raise its price to recover the costs of the special efforts made to sell the product. By definition then, the product for which vertical restraints can have any usefulness is one which is not in perfect competition with whatever substitutes may exist. This point, which was first made many years ago by Ward Bowman, one of the leaders of the Chicago school,[15] is absolutely central to the analytic problem we confront. For restraint to have either pro-efficiency or anti-competitive effect, the market in which it is employed must be imperfectly competitive. Hence the existence of restraints on subsequent conduct is strong evidence that some market power exists or, to paraphrase the proposed legislation, that the product is not in completely free and open competition. This is why the present judicial efforts to measure market power based on market shares in differentiated product markets misdirects analysis. Any restraint on subsequent conduct requires some market power regardless of function; consequently measuring the degree of power has little to do with determining whether the function the restraint is anti-competitive or efficient. This also suggests why the proposed legislation being considered today would also fail to distinguish between good and bad restraints if the concern is to permit efficiency enhancing ones and to prohibit those that are anticompetitive.

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[13] Assam Drug Store v. Miller Brewing, 798 F.2d 311, 316-317 (8th Cir. 1986).

[14] Continental TV v. GTE Sylvania, 433 U.S. 36, 54-55 (1977).

Our article concluded that neither the restrictive contracts nor the proposed legislation were justified on the evidence that we could collect assuming that the primary public policy goal was to protect economically efficient conduct. The legislation might still be justified, however, as an effort to allow a favored class of businesses, beer distributors, to create and exploit some power over price in order to enrich themselves at the expense of consumers. This is a form of subsidy or wealth reallocation and is one of the things that Congress does do; and sometimes, at least, it is justified. If that is the objective behind this legislation, I would urge that there should be overt recognition of it. Reasoned political debate requires acknowledgment of the real purposes for legislation, defense of the choice of beneficiary and the size of subsidy, as well as consideration of the possible methods of collecting and distributing the subsidy. In our article, we expressed concern with the justification for enriching beer distributors at the expense of beer consumers.[16] While we appreciate the contribution of distributors in getting beer to consumers, we found no evidence in the hearings to conclude that distributors are more worthy of special subsidy than any other wholesaler class. Secondly, if Congress did want to grant a subsidy to beer wholesalers, it appeared to us that authorizing a random tax on consumers whose amount would depend on the power, size and market situation of individual wholesalers is a very poor choice. If subsidy is to be given, why not establish a system to determine which wholesalers are truly worthy and then give them their subsidy directly. The money could even come from a special tax on beer. It will be simpler, surer, and more obvious to the public who is getting what.

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[15] Bowman, Resale Price Maintenance--A Monopoly Problem, 25 J. Bus. 141 (1952); Bowman, The Prerequisites and Effects of Resale Price Maintenance, 22 U. Chi. L. Rev. 825 (1955).

[16] Carstensen, Dahlson, supra note 1, at 74-80.

In sum, our article wound up taking a very negative view of the legislation. It was much more negative than we had expected when we started the project. It has also caused me to wonder whether in the real world of business there are any, let alone very many, situations in which distribution restraints do in fact satisfy the conditions of the efficiency theory.

Two Economic Facts About The Beer Industry

I now propose to elaborate on certain points which I think are particularly relevant to the decision to grant antitrust immunity to the beer industry. First, I want to stress two important facts about the beer industry which bear upon the questions of whether Congress needs to provide any special protection for that industry and the risks that special protection will result in anticompetitive consequences. These facts are the presence of pervasive state regulation and the highly concentrated structure of the industry at both the brewing and distribution levels.

Beer distribution is subject to pervasive state regulation. The 21st Amendment confers on the states broad powers to regulate the distribution of all alcoholic beverages, and the states without exception have adopted detailed regulatory schemes for this business. Many states control pricing, require distribution through exclusive territories and otherwise limit when and how distributors may compete. In addition, brewers may only sell to wholesalers while retailers, including taverns and restaurants, may only buy from wholesalers. Thus, for example, a retailer who has made a special, favorable purchase can not resell any of that beer to another less favored retailer. In fact, a bar owner can not buy at retail even if that would be cheaper. I suspect that such state regulation imposes more efficiency costs on the distribution of beer than any other factor affecting this business.

The presence of such active and pervasive state regulation also suggests that this is an area in which there is little need for Congressional intervention. If existing beer markets are not working properly, the states can respond by altering their regulations to authorize or forbid the conduct that is not desired. While state powers under the 21st Amendment are not absolute, it is clear that they are expansive. In addition, if a state determines that competition is undesirable in some aspect of its economy, it may replace it with a state regulated system, and that will be exempt from antitrust challenge as well. At present, state regulation of beer distribution is substantial and can be largely exempt from review under the federal antitrust laws.[17]

Second, the level of concentration in the beer industry is getting steadily more substantial. In 1986, a single brewer, Anheuser-Busch, had nearly 40% of all sales and a small group of 6 brewers produced over 90% of all beer sold in this country. Not only are these very high levels of concentration but they have been increasing over the years. I collected some of the most important structural data in three tables which are at the end of this statement. Table I sets forth the sales volumes of the leading brewers over the last 6 years based on the annual surveys published in Brewers Digest. I would note that except for Anheuser-Busch all brewers have had uneven growth records and in fact most of their growth in this period has come from acquisitions.[18] Table II shows changes in market share for each year for the largest, two largest, three largest and six largest brewers. This makes it evident that the very largest firms are continuing to gain market share. Table III reports my calculations of the Herfindahl Index numbers for the largest, two, three and six largest brewers. These index members are sensitive to the changes in distribution of market share and the Antitrust Division relies upon them in merger and vertical restraint analysis. The HHI numbers show a 500 point increase from 1981 to 1986. This is a very substantial change, and the national beer market has moved from one that many would say was only marginally concentrated to a situation of high concentration. Moreover, use of the national data probably understates regional power. If one were to use the Antitrust Division's Vertical Restraint Guidelines approach to analyzing these restraints, the HHI index numbers and the work of Professors Baker and Bresnahan[19] which points to substantial market power in the leading firms would make these restraints very suspect.[20]

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[17] I should note that the most recent Supreme Court decision interpreting the 21st Amendment does raise some question as to whether or not the requirement of exclusive territories without any review of how that policy was implemented would fare. 324 Liquor Corp. v. Duffy, ___U.S.___, 107 S.Ct. 720, 725 n. 6 (1987). However, the earlier case of Rice v. Norman Williams Co., 458 U.S. 654 (1982), provides support for the validity of this type of state action. Moreover, it seems reasonably clear that careful draftsmen can write state regulations which will pass muster under the 21st amendment or the state action doctrine or both.

[18] Judge Posner has contended that if the sales volumes of a firm decline after it adopts a distribution restraint, that would prove that the restraint had an anticompetitive function. On that basis, assuming most brewers adopted exclusive territories in 1983 when Anheuser-Busch did, we can see that all but Anheuser have lost volume in at least some years and so their restraints would be prima facie anticompetitive. I disagree with Judge Posner's theory. It ignores, among other things, independent market forces that may change demand. Our article elaborated on the reasons to reject the sales volume test. Carstensen, Dahlson, supra note 1, at 27-29.

While the data to do comparable analyses of the wholesale markets is lacking,[21] we do know that such markets are quite localized and that many wholesalers handle more than one major brewer.[22] As a result local market concentration in distribution in any area subject to exclusive territorial limits will be, at best, at the level of the brewers and frequently will be more concentrated. These levels of concentration carry with them grave risks of both monopolistic and collective exploitative behavior. It is especially important in such situations that restrictive agreements be subject to strict scrutiny since the risk of anticompetitive consequences is great.

In sum, despite some claims to the contrary, this is a highly concentrated, highly regulated industry in which the risks that restraints may be used to further

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19. See note 9 supra.

20. I should note that for the reasons I have mentioned earlier, I do not think that a market power oriented approach to evaluating the functions and consequent social utility of restraints is a desirable method of analysis.

21. Because these markets are generally much less than statewide the kind of data collected by Mr. Willett and presented in the 1984 hearings is of no relevance.

22. Carstensen, Dahlson, supra note 1, at 13.

anticompetitive strategies is very great. These considerations alone strongly argue against the adoption of the proposed legislation.

The Present State of Antitrust Law

I was surprised when I learned that the Malt Bill was still with us. I would have thought that the recent decisions interpreting and applying the antitrust law would have suggested that antitrust had become a toothless tiger which posed an insignificant threat to any restraint not expressly labeled as anticompetitive price fixing.[23] I understand and sympathize with the view that the courts have not provided general, clear and coherent standards for distribution restraints.[24] But today there are only minor gains to be had, I believe, in trying to avoid antitrust review. This is particularly so in the case of this legislation. As our article explained,[25] the wording of this proposed legislation suggests a number of ways to classify these restraints which would not only cause them to fall outside the exemption but could also create an inference that they were at least prima facie illegal.

In my view, given the very mixed, at best, record justifying these restraints, what is required, if we are to tolerate such restraints at all, is critical judicial review of specific restrictive agreements. Only at that level can one ask why a particular limit is needed, what function it serves and what alternatives exist. Traditionally, this is the function of antitrust law. Under a properly constructed rule of reason analysis, one would have expected courts to concern themselves with exactly these issues. Unfortunately, the tendency in the case law in general and in the key recent case on beer distribution in particular has been to focus on uninformative issues and circumvent the critical analysis.

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[23] Not only did Miller win in the Assam Drug case, Assam Drug Store v. Miller Brewing, 798 F. 2nd 311 (8th Cir. 1986), but the brewers have also persuaded the New York state courts that such restraints are per se lawful under that state's antitrust law. Anheuser-Busch v. Abrams, ___N.Y.S. 2nd___, 1987-1 Trade Cases Para. 67,469 (App. Div. 1987).

[24] We made this point in our analysis of antitrust law and the four different approaches which the cases reflect. Carstensen, Dahlson, supra note 1, at 63-74.

[25] Id. at 73-74.

Thus, in Assam Drug Store v. Miller Brewing, 798 F.2d 311 (8th Cir. 1986), the court in a very perplexing opinion dismissed without trial a challenge to territorial restraints in South Dakota that had caused an increase in wholesale prices without any evidence that such increased prices were essential to providing services of value to consumers. The court rested its decision solely on the spurious argument that Miller lacked market power. The argument is spurious because it is manifest that Miller's label was sufficiently differentiated that once competition among wholesalers was eliminated, the brand monopolist could in fact raise prices significantly.[26] The court quoted the passage from the Supreme Court's Sylvania decision which listed the efficiency enhancing uses that "may" occur and may justify such restraints in some cases, but the court failed to ask whether or not Miller required any of those activities from its distributors or whether restraint was needed in order to make it possible for the distributors to provide any such necessary activity.[27] In my view, the result is a very unhelpful standard for judging restraints.[28]

The use of the spurious market share--market power analysis has limited the effectiveness of judicial review of restraints in a wide variety of situations. It has caused and will continue to cause a great deal of uncertainty as to the outcome of particular cases. This problem has been pointed out at various hearings on this legislation over the years. I certainly agree that the present state of antitrust law with respect to restraint of trade analysis is not optimal. I do not think that the solution is to try to take more cases out from under the antitrust law. The best response is to clarify the general law.

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[26] See also, Jordan, Jaffee, supra note 6, for evidence of comparable effects in other states.

[27] 798 F.2nd at 315.

[28] For example, given Anheuser-Busch's nearly 40% market share and the evidence of power contained in the Baker, Bresnahan article, supra note 9, a court might have a hard time rejecting the contention that it has "market power." As a result, Anheuser is engaging in apparently illegal restraints of trade while its competitors with smaller shares would not be. Such a standard is capricious. I find it even harder to accept the position the major brewers have advanced in the pending litigation in the state of New York that their consciously parallel restraints should be exempt from judicial review because no one of them has "market power." Yet. it is manifest that whether the conduct is collusive or not, its economic impact is quite different if it is uniform and industry wide than if it is the isolated action of individual brewers.

There is a growing body of commentary which stresses that the important question in antitrust analysis when the reasonableness of distribution restraints is at issue is how in fact such restraints function. Such functional analysis would focus judicial review on the extent to which a specific restraint fulfills the expectations of the efficiency promoting theory, and whether any less anticompetitive alternative exists. In the long run, I would hope that the courts or Congress would direct the rule of reason analysis of restraints of trade in that direction and away from the irrelevant questions of market share and market power in the abstract. The result would be a clearer and much more workable approach to measuring reasonableness.

Redirecting the Malt Bill

If the fundamental objectives in setting policy with respect to distribution restraints are to allow only those restraints which advance economic efficiency and to forbid those whose primary function is to create, allocate or exploit economic power, then it is evident that neither the kind of sweeping and uncritical exemption which this legislation would confer nor the present standards being used by the courts to decide the reasonableness of distribution restraints are very satisfactory responses. I am sympathetic with the need for some reform in handling these cases. Perhaps the Malt Bill should be revised to require a critical examination of any restraints used in this industry. To do that the bill would have to be amended to forbid all distribution restraints except those shown to be necessary to the efficient distribution of beer and then only to the extent that no less restrictive alternative would achieve roughly similar results.[29] This would mean that at least in this industry the justifications for restraint in particular instances would be examined and would have to be proven instead of merely assumed.

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[29] One would, if serious about this approach, also have to address the scope of the permissible exemption for state mandated restraints.

Should Congress Act?

In the final analysis, I would not recommend adopting my suggested revision of the proposed legislation and as should be obvious, I do not think that it should be adopted in its present form either. I do not think that the distribution restraints of particular industries should be singled out for special treatment. There are two reasons for this.

First, it is very hard to make determinations about the reasonableness and economic justification for restraints on an industry wide basis. As the testimony over the years on this legislation shows, there is a good deal of disagreement about the merits of the conduct and the overall character of the industry.[30] Moreover, the data which proponents and opponents present has many flaws.[31] I can say with some certainty that the general efficiency claims for territorial restraints in beer distribution have no plausible support in the hearings before congress. I can not say that this establishes beyond any possible doubt that such a case could not be made. It simply has not been made. On the other hand, while the anticompetitive potential for these restraints seems quite likely based on those same hearings, the criticism of some of the evidence of adverse effects at least raises the question of how serious the harms are. In addition, even if, in general, these restraints may be anticompetitive and consequently undesirable, that does not disprove the possibility that in some instances they are important to effective competition.

The core of the disagreement over the years is how these restraints function. Here there are some remarkable non-sequiturs in the discussion. The most conspicuous example is the persistent denial by proponents of this legislation that it will have any effect on consumer prices even as they complain that transshippers cause them lost sales by undercutting their prices. The issue, as I have suggested, is more complex. What will consumers get in return for the somewhat higher prices they will have to pay?

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[30] There does appear to be some consensus emerging among scholars who have looked at various aspects of the industry in the last few years. I have collected six such article, other than our own, published within the last three years. Four of these articles identify various competitive problems in the beer industry. Baker, Bresnahan, supra note 9; Jordan, Jaffee, supra note 6; Tremblay, Strategic Groups and the Demand for Beer, 34 J. Ind. Econ. 183 (1985); Tremblay, A Reappraisal of Interpreting Rising Concentration: The Case of Beer, 58 J. Bus. 419 (1985). On the other hand, only one scholar, focusing on data from the 1970's, has found the industry to be very competitive. Lynk, Interpreting Rising Concentration: The Case of Beer, 57 J. Bus. 43 (1984); Lynk, The Price and Output of Beer Revisited, 58 J. Bus. 433 (1985).

[31] The kinds of data and tests that would be most relevant are discussed in Carstensen, Dahlson, supra note 1, at 61-63.

Before granting a sweeping antitrust exemption Congress needs the answers to these functional and effect questions. This is vital to a knowing and reasoned legislative judgment. To answer these questions in general Congress would need to obtain comprehensive information about the amount of price increases and exact nature of the changes in service. Is this committee prepared to invest the time, money, and effort in factual investigation and analysis to resolve those questions on an industry wide basis so that it can write relevant legislation? Should you use your time in that way?

The better focus, I suggest, is on the functioning of particular restraints in particular contexts. While such case specific analysis is much more practical, it is not a plausible legislative activity. The appropriate forum to focus on such issues is in fact a court in which the rules of evidence will demand that the parties approach factual claims with some greater concern for proof. It is, therefore, my suggestion that the best response at this time is to leave these questions to the courts.

My second reason for urging that you not enact this legislation is that it does a major disservice to the boarder concern of clarifying the law governing distribution restraints. There is nothing unique in the beer situation. It reflects the general problems of all industries in which some restraints exist in the producer-distributor-retailer relationships. I agree that it would be very helpful to clarify the legal policy and standards governing such situations. But such clarification ought to be in general terms that courts can apply in specific industrial contexts to specific restraints. The task of reformulating the standards of antitrust is not easy. I am not sure it is best done legislatively rather than judicially. Nonetheless, if this subcommittee had the interest and will to pursue these questions at that level, a more useful outcome might be possible.

My final message is therefore that you do not have the kind of factual record before you which justifies, on efficiency grounds, the legislation that you are considering. Nor can you make such a record without a major effort. This legislation might still be justifiable as an effort to provide an ad hoc subsidy to beer brewers and distributors, but I would suggest even then the record fails to justify the choice of parties to receive a subsidy, or the method used to confer the subsidy. Consequently, I would respectfully recommend that you not adopt this legislation.

Table I

Sales Volume of Major Brewers In Millions of Barrels

	1981	1982	1983	1984	1985	1986
Anheuser-Busch	54.5	59.1	60.5	64.0	68.0	72.3
Miller	40.3	39.3	37.5	37.5	37.1	38.7
Stroh*	6.2	22.9	24.3	23.9	23.4	22.8
Heileman	14.0	14.5	17.6	16.8	16.2	16.1
Coors	13.3	11.9	13.7	13.2	14.7	15.2
Pabst	13.5	12.3	12.8	11.6	9.5	7.1
All Beer Sold Inc. Imports	179.5	179.5**	183.5	183.7	184.8	188.1

Source: Brewers Digest, annual surveys, 1982-1987.

* Stroh acquired Schlitz in 1981-82 and thereafter became the third largest brewer in the country.

** Brewers Digest did not provide a total volume for this year, but did state it was approximately the same as the prior year.

Table II

Market Shares of Major Brewers
As a Percentage of the Volume of All Beer Sold

	1981	1982	1983	1984	1985	1986
Largest	30.3	32.0	32.5	34.6	36.8	38.4
2 Largest	52.8	53.3	52.5	55.0	56.8	58.9
3 Largest*	60.8	65.7	65.5	67.8	69.5	71.1
6 Largest	82.7	86.9	89.2	90.1	91.3	91.6

Source: Market shares calculated from Table I for 1981; markets shares for 1982-1986 based on reports in Brewers Digest except for Pabst in 1982 which was also caluculated from Table I.

* In 1981, Schlitz was the third largest brewer with a sales volume of 14.3 million barrels. Starting in 1982, Stroh and Schlitz were a single concern.

Table III

HHI Index Numbers Based on Sales Volume

	1981	1982	1983	1984	1985	1986
Largest	918	1024	1056	1197	1354	1475
2 Largest	1424	1478	1456	1613	1754	1895
3 Largest	1488	1631	1625	1777	1916	2044
6 Largest	1660	1782	1816	1947	2081	2198

Source: Calculated from Table II and underlying market share data for individual firms as report in Brewers Digest.

Senator DeConcini. Mr. Carstensen, thank you.

Mr. Tollison.

Mr. Tollison. Thank you very much. My name is Bob Tollison and I teach economics at George Mason University in Fairfax. I am also Director of the Center for Study of Public Choice there, and I am very proud to say that my colleague in the Center, Jim Buchanan, was awarded the 1986 Nobel Prize in economic science.

I am here today to testify on the proposed Malt Beverage Interbrand Competition Act. Specifically, I would like to put some evidence on the table for the consideration of the committee which is the result of an extensive study that I have done over the past 6 months on the impact of exclusive territories on beer prices across U.S. States.

Thus, in my study I looked at a key issue—the impact of territorial arrangements on beer prices across States. I found that beer prices are not impacted at all by exclusive territories for beer distributors. If anything, beer prices are lower where exclusive territories are mandated and are higher in Indiana where exclusive territories are specifically outlawed.

My study, in contrast to other studies, was carefully designed and specified. I held constant other important determinants of beer prices, such as beer consumption across States, consumer real income across States, advertising restrictions across States, and other relevant factors that affect beer prices across States. After these factors are accounted for, exclusive territories have no discernible statistical, empirical impact on beer prices across U.S. States.

My results are corroborated by other studies, such as the one done fortuitously by the State of Michigan which showed that beer prices continued to fall significantly after the mandating of exclusive territories in that State in early 1977.

For the committee's vision, this experience in Michigan, which was an independent study conducted by the Department of Public Health in Michigan, is depicted on the chart to my left. As you can see, Michigan beer prices were mirroring what has been a national trend for the past 30 years of declining real prices.

But, indeed, after the exclusive territories law was passed, they continued to fall. So that is one independent corroboration of the kind of result that I find in my more extensive investigation of U.S. States. More recently, there is a study by two economists at Auburn University in Alabama which also corroborates this kind of finding for the State of Alabama.

These results are consistent with a pro-competitive role for exclusive territories in beer distribution. Such distributional arrangements increase the efficiency with which beer consumers are served in the nation's marketplaces and do not lead to higher beer prices where there is significant competition among competing brands.

Other studies of beer prices of which I am aware are virtually worthless in helping this committee or anyone else assess the impact of distributional arrangements on beer prices.

Here, I refer to the so-called Indiana study, the New York study, and to a study by Dr. Mark Cooper sponsored by a consumer group. The so-called Indiana study appears to be non-existent and claims a result contrary to my findings that beer prices are made higher in that State by the outlawing of exclusive territories.

The New York study has little to commend it. It simply offers raw data on retail prices without any explanation of why they differ or why they change over time. Moreover, we are not told how these data were collected.

Finally, in several quite serious ways, the Cooper study is so flawed in its econometric work as to be of no substantive merit whatsoever.

In sum, it is my opinion that the malt beverage bill will not harm consumers at all, but will serve to deter spurious litigation and allow beer distributors to concentrate on what they do best, provide quality beer to beer consumers at competitive prices.

Thank you very much.

[Prepared statement plus additional material submitted by Mr. Tollison follows:]

Statement of

Dr. Robert D. Tollison
Professor of Economics
George Mason University
Fairfax, Virginia 22030

I appreciate the opportunity to appear here today. My name is Robert Tollison, and I am a Professor of Economics at George Mason University in Fairfax, Virginia. As a professional economist, I have published over 100 articles in leading economic journals, many of which are related to the subject matter of antitrust and industrial organization. I have authored or edited thirteen books, and I am the coauthor of a basic economics textbook for college use published by Little, Brown. I have also served in government as a Senior Staff Economist on the Council of Economic Advisers (1971-72) and, more recently, as Director of the Bureau of Economics at the Federal Trade Commission (1981-83). The latter position is a senior antitrust enforcement position at the FTC.

I am here today to testify with respect to the proposed Malt Beverage Interbrand Competition Act, S.567. More specifically, I want to report to the Subcommittee the results of an extensive investigation that I have made on the effects of exclusive territories in the malt beverage industry. This study has been submitted to the Subcommittee for its review, and the following remarks are the major findings of the study.

Most reliable accounts suggest that the beer industry is characterized by intense competition among manufacturers, manufacturers' brands, and their distributors. Between 1982 and 1986, for example, the number of licensed breweries in the U.S. rose by nearly 30 percent. More importantly, retail beer prices have increased at approximately the same rate as wine prices, and more slowly than those of cola and coffee from 1967 through 1982. Among the vast array of beverages with which beer competes for the consumer's dollar, only the prices of distilled liquor and milk rose more slowly over this period. Indeed, according to the Bureau of Labor Statistics, real beer prices, computed in constant 1967 dollar terms, actually fell at a compound rate of 1.7 percent per year from 1964 to 1985. Our own independent estimates suggest a decline in real beer prices, measured in constant 1984 dollar terms, of between 0.9 and 1.6 percent per year from 1957 to 1985. This and other evidence relating to the beer distribution system suggests that the proposed clarification of the legality of exclusive territories by the Malt Beverage Interbrand Competition Act would be pro-competitive and efficient from the perspective of consumer welfare.

Currently, the legality of exclusive territories in the beer industry is a matter of state law. Evidence as to whether or not the use of territorial restrictions in the distribution of beer enhances consumer welfare can be obtained by examining the effects of such non-price restraints on retail beer prices in those states which mandate exclusive territories versus retail beer prices in other jurisdictions. One bit of evidence in this regard comes from the experience of Michigan, a state where a law requiring the assignment of exclusive beer distribution territories took effect in January 1977. A study by the Michigan Department of Public Health showed that from 1967 to 1983, the prices of beer sold in Michigan declined relative to those of most consumer goods. In constant dollar terms, a six-pack of beer that cost Michigan's consumers $1.23 in 1967 cost only 91 cents in 1983. More importantly from the standpoint of S.567, real beer prices in Michigan declined from $1.04 a six pack in the year before the exclusive territory law to 91 cents a six pack in 1983, seven years later. This price decline would not have been possible had exclusive beer distribution territories in Michigan worked to the detriment of consumer welfare. On the contrary, beer prices in Michigan clearly continued their steady downward trend following the passage of exclusive territory legislation. Indeed, on the basis of its independent study the Department of Public Health concluded that the performance of beer prices in the state represented "an enviable business achievement by beer manufacturers."

Similarly, a study conducted by economists at Auburn University showed that beer prices fell by 11 cents per six-pack in Alabama after enactment of exclusive territories legislation in 1984, compared to an average 11 cent increase in the rest of the nation over the same period. The authors concluded that "although many factors enter into the pricing of beer and wine, no evidence can be found in these data that the territorial bill has been harmful to the Alabama consumer."

Thus, the evidence from two independent studies of the effects of exclusive territories on beer prices suggests that such legislation works to the benefit of beer consumers. To investigate the effects that state-granted exclusive territories legislation has in the beer industry nationwide, we developed and estimated an econometric model to explain cross-state variations in the retail price of beer. The model incorporates the fundamental economic factors which interact to determine the prices of beer in each of the fifty states. These factors include consumer income; the prices of related goods such as wine, soft drinks, and distilled spirits; labor costs; congestion-service capacity;

state laws restricting beer advertising at retail; and the presence or absence of state-mandated exclusive territories.

In contrast to the flawed study conducted by Dr. Mark Cooper for the Consumer Federation of America, our findings indicate that retail beer prices are no higher or lower in states that mandate exclusive territories than in other states, once the effects of other relevant factors affecting retail beer prices are taken into account. (Indeed, the results suggest that retail beer prices tend to be lower in states mandating exclusive territories, but this finding does not reach standard levels of statistical significance.) Clearly, if exclusive distributorships were a method of monopolizing markets and charging retailers higher prices, these effects would show up in the prices paid by beer consumers. The data reject this interpretation. Indeed, in one variation of our tests Indiana was treated as a separate case where exclusive territories are prohibited versus all other states where such arrangements are permitted or required -- all else equal, beer prices were higher in Indiana.

The findings concerning the effects of the other factors considered on the retail prices of beer are consistent with the predictions of economic theory. Specifically, retail beer prices are higher in those states where consumer incomes, prices of a close substitute (wine), and labor costs are higher. Similarly, retail beer prices tend to be lower in states where per capita consumption is higher and where there are higher levels of service congestion (because of fewer retail food, eating and drinking establishments per capita).

The study does uncover one source of artificially high retail beer prices. The results show that retail beer prices are substantially higher, given other factors, the greater the number of ways in which state law restricts or prohibits retail beer advertising. In particular, restrictions and prohibitions on exterior signs and interior window signs which can be seen from the exterior each raise retail beer prices by about 15 cents per gallon (1967 dollars). Newspaper and magazine advertising restrictions raise retail beer prices by approximately 18 cents per gallon (1967 dollars). Thus, it appears to be state-imposed advertising restrictions, and not exclusive territories, that are the culprits which artificially raise retail beer prices through their competition-reducing effects.

In sum, our study is fairly conclusive on the question of whether exclusive beer distribution territories will harm or enhance consumer welfare. After a detailed analysis of the effects of state-mandated exclusive territories on the prices of beer at retail, we find that if there is any effect at all, state-mandated exclusive territories lead to lower retail beer prices. There is no evidence that exclusive territories lead to higher retail prices. The only conclusion that can be drawn from the evidence is that the clarification of the antitrust treatment of the territorial distribution system proposed by the Malt Beverage Interbrand Competition Act would be pro-competitive and efficient from the perspective of beer consumers.

THE ECONOMIC EFFICIENCY OF GEOGRAPHIC RESTRAINTS IN THE MALT BEVERAGE INDUSTRY

by

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and

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AUBURN UNIVERSITY

June, 1987

Executive Summary

Modern economic theory recognizes that certain types of vertical restraints, which limit competition between the wholesalers or retailers of a product, can work to the benefit of consumers by enhancing competition with other brands or with closely related products. One such vertical restraint is represented by contractual arrangements between manufacturers and wholesaler-distributors granting the wholesaler-distributor the sole and exclusive right to sell and distribute a product within a given geographic area. Exclusive territories promote competition between brands by eliminating "free-rider" effects and by providing incentives for wholesaler-distributors to assist retailers with quality control and other point-of-sale services. Because, however, vertical restraints can in some circumstances lead to lessened competition, it is necessary to examine each case on its own merits.

This study analyzes the effects of exclusive territories in the malt beverage industry. Most reliable accounts suggest that the beer industry is characterized by intense competition among manufacturers, manufacturers' brands, and their distributors. Between 1962 and 1986, for example, the number of licensed breweries in the U.S. rose by nearly 30 percent. More importantly, retail beer prices have increased more slowly than those of milk, wine, cola, and coffee from 1967 through 1982. Among the vast array of beverages with which beer competes for the consumer's dollar, only the price of distilled liquor rose more slowly over this period. Indeed, computed in constant 1967 dollar sented "an enviable business achievement by beer manufacturers."

Similarly, a study conducted by economists at Auburn University showed that beer prices fell by 11 cents per six-pack in Alabama after enactment of exclusive territories legislation in 1984. By comparison, during the same time period, average beer prices nationally increased by 11 cents per six-pack. The authors concluded that "although many factors enter into the pricing of beer and wine, no evidence can be found in these data that the territorial bill has been harmful to the Alabama consumer."

Thus, the evidence from two independent studies of the effects of exclusive territories on beer prices suggests that such legislation works to the benefit of beer consumers. To investigate the effects that state-granted exclusive territories legislation has in the beer industry nationwide, we developed and estimated an econometric model to explain cross-state variations in the retail price of beer. The model incorporates the fundamental economic factors which interact to determine the prices of beer in each of the fifty states. These factors include consumer income; the prices of related goods such as wine, soft drinks, and distilled spirits; labor costs; congestion-service capacity; state laws restricting beer advertising at retail; and the presence or absence of state-mandated exclusive territories.

In contrast to the flawed study conducted by Dr. Mark Cooper for the Consumer Federation of America, our findings indicate that retail beer prices are no higher or lower in states that mandate exclusive territories than in other states, once the effects of other relevant factors affecting retail beer prices are accounted for. (Indeed, the results suggest that retail beer prices tend to be lower in states mandating exclusive territories, but this finding does not reach standard levels of statistical significance.) Clearly, if exclusive distributorships were a method of monopolizing markets and charging retailers higher prices, these effects would show up in the prices paid by beer consumers. The data reject this interpretation.

The findings concerning the effects of the other factors considered on the retail prices of beer are consistent with the predictions of economic theory. Specifically, retail beer prices are higher in those states where consumer incomes, a close substitute's (wine) price, and labor costs are higher. Similarly, retail beer prices tend to be lower in states where per capita consumption is higher and where there are higher levels of service congestion (fewer retail food, eating and drinking establishments per capita).

The study does uncover one source of artificially high retail beer prices not considered in the Cooper study. The results show that retail beer prices are substantially higher, given other factors, the greater the number of ways in which state law restricts or prohibits retail beer advertising. In particular, restrictions and prohibitions on exterior signs and interior window signs which can be seen from the exterior each raise retail beer prices by about 15 cents per gallon (1967 dollars). Newspaper and magazine advertising restrictions raise retail beer prices by approximately 18 cents per gallon (1967 dollars). Thus, it appears to be state-imposed advertising restrictions, and not exclusive territories, that are the culprits which artificially raise retail beer prices through their competition-reducing effects.

In sum, our study is fairly conclusive on the question of whether exclusive beer distribution territories will harm or enhance consumer welfare. After a detailed analysis of the effects of state-mandated exclusive territories on the prices of beer at retail, we find that if there is any effect at all, state-mandated exclusive territories lead to lower retail beer prices. There is no evidence that exclusive territories lead to higher retail prices. The only conclusion that can be drawn from the evidence is that the clarification of the antitrust treatment of the territorial distribution system proposed by the Malt Beverage Interbrand Competition Act would be pro-competitive and efficient from the perspective of beer consumers.

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I. VERTICAL RESTRAINTS IN THE MALT BEVERAGE INDUSTRY

Regulation of industry structure has undergone significant changes over the past 10 years. Industries such as airlines and trucking have been deregulated in many dimensions. Many unnecessary regulations have been eliminated from the work place. The impact of environmental and other regulations has been scrutinized in order to determine their effects upon economic efficiency and general consumer welfare.

Behind many of these regulatory changes is a "new" theory of industrial organization. This new theory is based, among other features, on a broadened concept of competition and ultimate market performance rather than upon the simple number of firms in the industry. For example, the new industrial organization identifies interindustry competition as a major ingredient in determining economic welfare. A four-firm concentration ratio of fifty or sixty percent in some narrowly-defined industry, e.g., leather, is no longer prima facie evidence of reduced competitiveness. Leather, after all, must compete with plastics, wool, cotton and fibers of all kinds in most relevant markets. Domestic firms face increasing competition from foreign producers in many industries. The courts, antitrust enforcement agencies, and the regulatory arm of the Office of Management and the Budget have all used wider standards of conduct and performance in gauging the impact of market structures on consumer welfare. While the number of firms in an industry, interrelationships with other industries, entry conditions, and other aspects of market structure still count from a regulatory perspective, performance characteristics with respect to price, quality, and consumer service have begun to make a significant impact on legal and legislative decision-making. The trend in antitrust law and enforcement has been clearly established in the direction of greater degrees of open competition.

The Issue of Vertical Restraints.

Within the overall tone of competitiveness, one issue remains unclear from both a theoretical and a policy perspective. In the seemingly infinite number of variations on total market structure within narrowly-defined "industries," vertical restraints present an interesting and perplexing issue. Vertical restraints comprise any terms, contracts, or agreements between the manufacturer and the distributor-wholesalers of a product which relate to the exact conditions under which the product can be sold at wholesale and retail. Some of these conditions or terms may include minimum price or quality standards, conditions of sale to wholesalers or retailers, and, importantly, defined limits on geographical distribution of the product.

Some form of vertical restraints is common in many industries. The tightest form of vertical restraint is, of course, downstream ownership and control by manufacturers of a good or service. Exxon Oil Company or Holiday Inns are examples of such restraints. In such integrations of manufacturing and distribution, quality characteristics are kept under tight control, and geographic competition (within brand) is narrowly conscribed. Franchising, so common in recent fast-food economic history, is yet another form of vertical restraint. The major aspect of such restraints is, like vertical integration, the insurance of quality and the limitation of geographic intrabrand competition. In the case of franchising, however, provision of services by the franchisor (such as advertising, the availability of quality-controlled inputs, etc.) are given in return for a franchise fee and for contractual assurances of quality.

Other market structures are characterized by somewhat less formal kinds of vertical restrictions. These intrabrand restraints, which evolved slowly over time, are similar in motivation to those of downstream integration and formal franchising. The soft drink and malt beverage industries are characterized by these kinds of quality and geographic restraints. The essential question respecting all kinds of vertical restraints is whether, for purposes of economic policy, (a) such restraints contribute to inefficiency and welfare loss in markets, or (b) whether efficiency and consumer welfare are unharmed or even enhanced by such a policy. These questions regarding the effects of vertical restraints (both price and non-price) have been scrutinized carefully over the past few decades by economists and policymakers. The issues have undergone considerable analytical refinement as well.

The Logic of Vertical Restraints.

On the negative side, restraints such as resale price maintenance and geographical restrictions could create or facilitate collusion, permitting or creating restrictions on horizontal firm competition. Modern economic theory suggests opposite effects. Since market structure usually evolves in an efficient manner, it seems reasonable that a manufacturer's choice of a distribution system reflects a clear judgment concerning the efficiency and effectiveness of selling its product. The choice of a particular marketing system, in other words, will be premised upon the most efficient (in the eyes of the particular manufacturer) means of competing with other brands or with closely related products. Consumers as well as manufacturers and all firms in the chain of distribution benefit from enhanced competition.

The logic of vertical restraints is further enforced by the following considerations:

(1) The Elimination of Free Rider Effects. In many cases products (automobiles, for example) require maintenance or after-purchase service. Without vertical restraints such as exclusive territories, transshippers and other sellers would "free ride" on distributors who did provide these services. The marketing arm of the competitive system breaks down in such cases since competitors not providing services are able to charge lower prices by attempting to shift burdens to distributors providing services. The latter, however, meet this competition (lower prices) by reducing service, and the process continues until quality is eroded at the retail and consumer levels. These free rider effects are avoided with exclusive territories.

(2) Quality Control and Point-of-Sale Assistance. Exclusive distributors are, for reasons similar to the case of the "free rider," necessary to control the quality of some final products. For example, full-service dealers who provide technical data about product performance, warranty terms, and so on would be injured if customers were able to make their purchase decision at

one location and then buy from a nearby dealer who, because he did not supply such ancillary services, could sell the same product at a discount. Similarly, a distributor dealing with retail stores buying from multiple suppliers of the same item will lose incentive to rotate stocks, to carry sufficient inventory in order to meet normal customer demands, to participate in promoting and developing brands, and to provide informational services to retailers. The 1982 FTC decision in the Beltone case, for example, held that exclusive territories "may increase local merchandising, promotion and service activities of wholesalers, and might increase output."[1] These arrangements also permit sales and service to small retailers and increase brand selection to the consumer.

For these general reasons, evidence in most markets points to the fact that exclusive territorial arrangements increase competition and enhance consumer welfare, and provide no entry barriers for new and potential entrants. Indeed, when vertical restraints improve and encourage overall competitiveness, new entry may actually be facilitated.

The Legality of Vertical Restraints.

Over the past decade the courts have found this kind of economic logic persuasive. A 1967 decision (U.S. v. Arnold, Schwinn and Co., 388 U.S. 365 (1967)) had found exclusive territories to be illegal *per se*. This rule held that the use of non-price restraints, such as exclusive territories, in any market was unlawful. Under present law, developed in the Sylvania decision (Continental T.V. v. GTE Sylvania, 433 U.S. 36

(1977)), the legality or illegality of exclusive territories will be judged by the "rule of reason." The Sylvania court argued that exclusive distributorships could be pro-competitive in some industries, citing the "free rider" problem discussed above and some of the quality benefits that can be induced by the assignment of exclusive territorial agreements.[2] The Reagan administration has vigorously supported such agreements. The Department of Justice's Antitrust Division maintains that such agreements are lawful except under exceptional circumstances. Specifically, if competition is vigorous -- in particular as measured by low concentration at the manufacturing or wholesale level or by ease of entry -- exclusive territories are not likely to be anticompetitive.[3]

The Malt Beverage Industry: Characteristics

Within this economic and legal framework the malt beverage industry is seeking legislative clarification of the "circumstances under which territorial provisions in licenses to distribute and sell trademarked malt beverage products are lawful under the antitrust laws."[4] Specifically, the Malt Beverage Interbrand Competition Act would permit, state laws also permitting, the inclusion and enforcement of contractual arrangements between malt beverage manufacturers and wholesaler-distributors granting the wholesale distributor the sole and exclusive right to sell and distribute a product within a given geographic area. The Act also contains provisions which require that the product be in "substantial and effective competition with other malt beverage products within that defined geographic area" and that no (Sherman-Clayton) antitrust provisions respecting illegal price-fixing, horizontal restraints, or boycotts are violated.

We believe that the structure and performance characteristics of the malt beverage industry (hereafter the beer industry) clearly make the proposed legalization of the territorial distribution system pro-competitive and efficient from the perspective of consumer welfare. Before considering formal evidence of the efficiency of that system in Sections II and III of this report, first consider an informal description of the beer industry and of its characteristics and, secondly, an analogy to the efficiency of the soft drink market and distribution system.

The Three-Tier System and Exclusive Territories. In common with many other distribution systems, beer marketing is characterized by a three-tier system. The cornerstones of this system are:

a. beer manufacturers sell to wholesalers which, according to laws and regulations in many states, distribute beer within exclusive territories designated by the manufacturers;

b. distributors, in active competition within the beer market and in the market for beverages in general, sell to retail stores, small and large, restaurants, bars, and all other retail outlets for beer; and

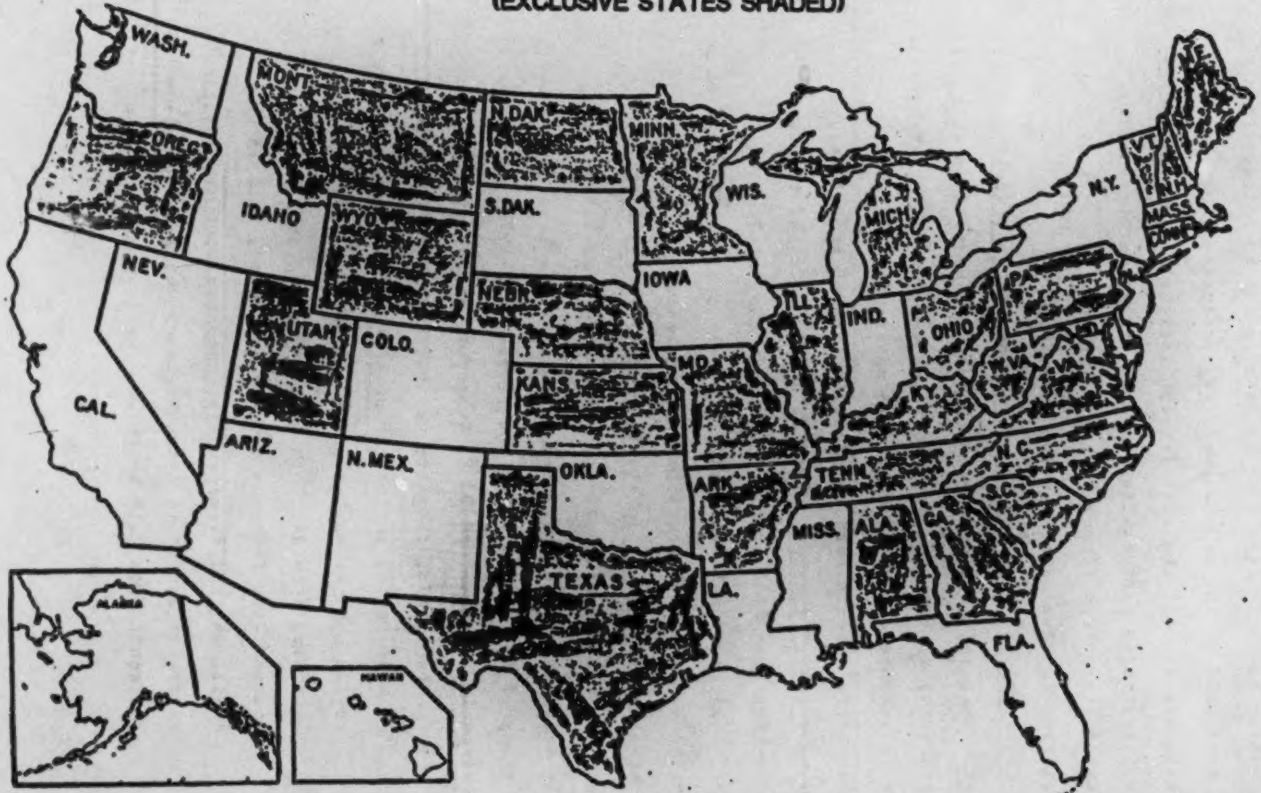
c. retailers, which stock a large number of beer brands as well as a variety of alcoholic and non-alcoholic beverages for final sale to consumers.

This system has stood the test of time in the beer industry with well over half of the states *mandating* exclusive territories for distributors and all the rest (except Indiana) either silent or neutral regarding distribution through exclusive territories. (Figure 1 presents a summary map of state positions on exclusive territories for beer distribution in 1985.)

Competitiveness at the Manufacturing and Distribution Stages. Most reliable accounts of general competitiveness in the beer industry at both the manufacturing and distributional levels point to intense competition between manufacturers, manufacturers' brands, and the distributors of beer. Figure 2, from the *Brewers' Almanac*, gives an a indication of the number of breweries from 1968 to 1986. In 1986 the total number of licensed U.S. breweries stood at 113, an increase of 26 breweries between 1982 and 1986. At the manufacturing level, concentration ratios *within the beer industry alone* (i.e., without the consideration of other beverage competition) give little indication of competitiveness within the beverage market. In a study of the industry for the period 1952-1971, for example, economists K.J. Hatten and D. E. Schendel conclude that

> the brewing industry underwent a major transition. In this period the number of breweries declined from 357 to 148 and the market share of the four largest brewers increased from 24.2% to 48.5%. During this same period, however, the fortunes of many companies, both large and small, shifted dramatically. Schlitz lost its position as market leader to Anheuser-Busch whose market share increased from 7.1% to 19.2%. Once prominent large

STATE - MANDATED EXCLUSIVITY
(EXCLUSIVE STATES SHADED)


WASH.
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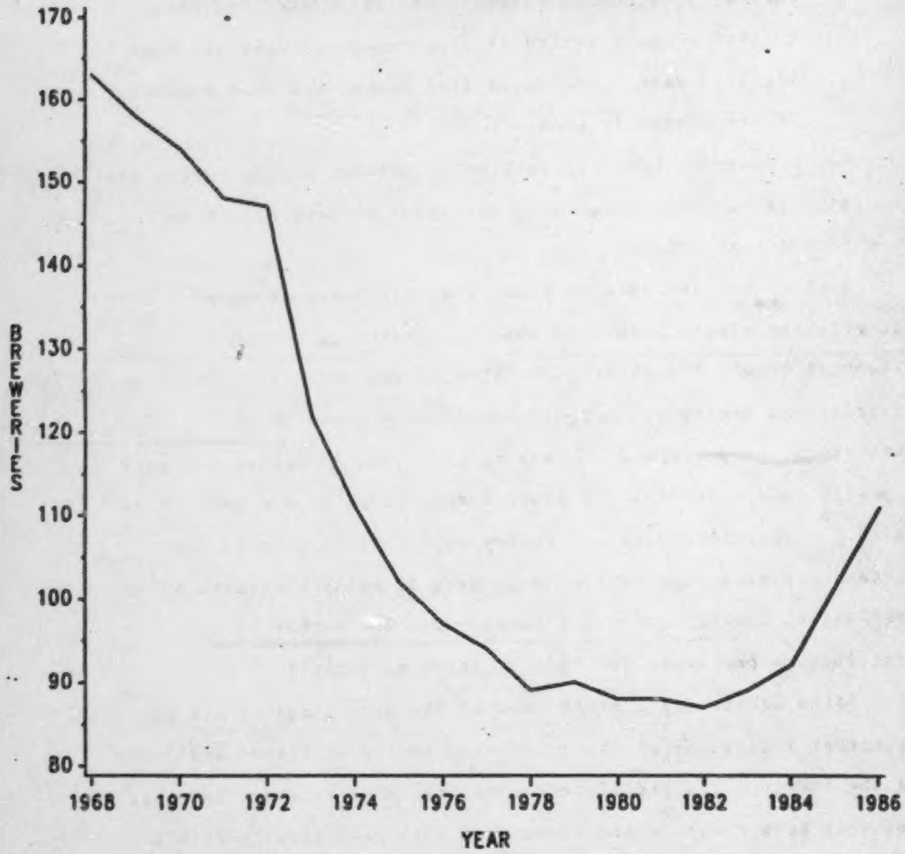
TEXAS
MINN.
IOWA
MO.
ARK.
LA.
WIS.
ILL.
MISS.
MICH.
IND.
OHIO
KY.
TENN.
ALA.
GA.
FLA.
W.VA.
VA.
N.C.
S.C.
PA.
N.Y.
VT.
N.H.
MASS.
CONN.
ALASKA
HAWAII

FIGURE 1

8A

NUMBER OF U. S. BREWERIES : 1968-1986



SOURCE : BREWERS ALMANAC

FIGURE 2

> firms like Ballentine and Blatz disappeared while firms like Carling, Hamm, Falstaff and Associated Breweries enjoyed a short period of vigorous prosperity and then began to wane. Companies like Coors, and more recently Miller, began to grow.[5]

Evidence of intense competitive rivalry between manufacturers and the entry and exit of firms into the industry continues over more recent time periods.

Significant and intense rivalry at the level of beer distribution also exists. In 1984, according to testimony presented before the Senate Committee on the Judiciary, "beer distributors are by and large independently owned small businesses; 93 percent . . . employ less than 50 people and make a profit before Federal and State income taxes of 4.6 percent on sales."[6] The distribution industry employs more than 80,000 workers and each firm typically invests $1 million in capital -- warehouses, trucks, and other equipment. The number of beer distributors per state for 1986 is shown in Table 1.

Large numbers of distributors in the beer industry are an important indication of the increasing number of brands available in the market. The proliferation of brands of beer has developed not only from domestic production but also dramatically rising imports of beer as well (see Figure 5 of this paper). In any given geographic area, an increasing number of brands signals a larger number of distributors which mirrors intense rivalry within the entire industry. Prices in such competitive markets, as in the well-known conclusion of economic theory, will

TABLE 1: Beer Distributors Per State : 1986

STATE	NUMBER	STATE	NUMBER
ALABAMA	56	MONTANA	45
ALASKA	9	NEBRASKA	50
ARIZONA	54	NEVADA	23
ARKANSAS	51	NEW HAMPSHIRE	17
CALIFORNIA	254	NEW JERSEY	47
COLORADO	60	NEW MEXICO	30
CONNECTICUT	22	NEW YORK	162
DELEWARE	5	NORTH CAROLINA	94
FLORIDA	97	NORTH DAKOTA	29
GEORGIA	74	OHIO	146
HAWAII	18	OKLAHOMA	57
IDAHO	36	OREGON	89
ILLINOIS	196	PENNSYLVANIA	404
INDIANA	122	RHODE ISLAND	10
IOWA	80	SOUTH CAROLINA	59
KANSAS	60	SOUTH DAKOTA	29
KENTUCKY	66	TENNESSEE	46
LOUISIANNA	77	TEXAS	286
MAINE	16	UTAH	19
MARYLAND	55	VERMONT	12
MASSACHUSETTS	42	VIRGINIA	78
MICHIGAN	165	WASHINGTON	100
MINNESOTA	117	WEST VIRGINIA	62
MISSISSIPPI	57	WISCONSIN	173
MISSOURI	92	WYOMING	33

Source: Brewers Almanac, 1986

approximate the costs of production and distribution.

Service Characteristics and "Free Riding" in Beer Distribution. In spite of the allegations of some critics, beer distibution has numerous service dimensions. Product quality must be assured, retail sellers, both large and small, must be serviced, and beer promotions and point-of-sale activities are all part of the role of the franchised distributor. These activities are all part and parcel of the competitive process by which beer is distributed and marketed. The statement of William Young, president of Wholesale Beer Company of Atlanta, Georgia, outlines the typical competitive activity of the wholesale distributors:

> In my State of Georgia draft beer is about 12 percent of all the beer sold. It has a much shorter, natural, shelf life because it is not pasteurized. We have to, therefore, make a substantial investment in large coolers and warehouses to keep a watchful eye on the cleanliness of everything that we do relative to draft beer.
>
> Bottle and canned beer has a longer normal shelf life. The standard is set by the brewery. The standards vary by the breweries. If we do not maintain the quality of the product, we are subject to being terminated by our brewers. We are required by suppliers to watch the shelf life of these products in these warehouses and in the retail customers establishments.
>
> We make sure that the product is rotated according to age at our warehouse, . . . on our trucks, and

> the retailers' coolers, floors, shelves, and storage rooms. When the normal shelf life date is exceeded, we pick up the beer from the retailer's place of business. We replace it with fresh beer and destroy the old beer at our cost.[8]

It is clear, moreover, that the "free rider" problem -- overlapping competition from other distributors or "trans-shipping" exists and is significant in the beer industry as it is in many others.[9] As Mr. Young notes:

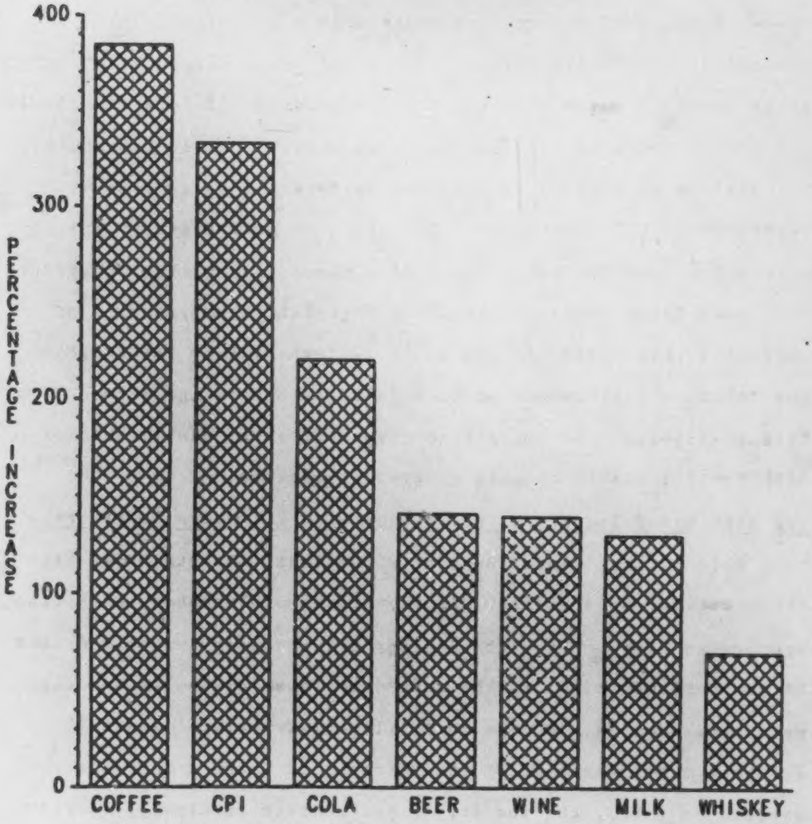
> If I was not the only Pabst distributor in the Atlanta market, the entire quality control program of the Pabst Brewing Co. would fall apart. I could not identify which Pabst I sold to the retailer and which Pabst some other distributor would have sold to the same retailer.
>
> And I would certainly not spend money to control the quality of a product I did not sell. Yet, if my brand of beer goes off taste, even if I did not sell it, the brand suffers and so do I. This is because the consumer will switch, and he does, brand preference.[10]

Not only does quality control of the product itself suffer from intrabrand competition at regional levels, but other dimensions of competition such as display advertising, special promotions, retailer education and assistance, and steady supply availability suffer as well with "trans-shipping." Indeed, our empirical results strongly support the fact that beer advertising restrictions across states (reported in Section III of our research) have a positive and significant impact upon beer prices.

Overall Competitive Performance. The relevant market for beer is, of course, vastly understated when beer alone is considered. Beer is in competition with many other kinds of beverages, including wine, distilled spirits, and the massive array of non-alcoholic beverages. If concentration or monopoly elements were at all significant in the overall beverage market, we would expect to observe retail prices or profit margins of manufacturers or distributors to be rising over time. Figure 3 provides an indication of price increases of selected beverages compared to the rise in the Consumer Price Index from 1967 through 1986. Next to the price of whiskey and milk, nominal beer prices at retail have risen less than those of cola and coffee and approximately the same as wine over the period. The increase in the average price of colas over the period is in large measure due to shifts in tastes of the population. Since 1967, consumers have tended to shift consumption away from alcoholic beverages toward soft drinks. This, in large part, led to the explosion in the diet and sugar-free cola demand producing a relatively large price increase for colas. Further, according to data from the Bureau of Labor Statistics, real beer prices computed in constant 1967 dollars fell at a compound rate of 1.7 percent per year from 1964 to 1985. Between 1968 and 1985, average hourly earnings for production workers in the malt beverage industry rose four-fold (391%) in contrast to earnings in all manufacturing (315%) and in all food (299%).

Such informal evidence relating to all three stages of the malt beverage industry leads to a clear indication of the general

SELECTED BEVERAGE PERCENTAGE
PRICE INCREASES : 1967-1986



SOURCE : BUREAU OF LABOR STATISTICS

FIGURE 3

competitiveness of the industry over the past 35 years. The purpose of our study, however, is to demonstrate formally the efficiency of vertical restraints in a number of dimensions, including prices, output and, more importantly, full price (nominal price plus quality dimensions). Before turning to our formal evidence relating to these matters, it is instructive to consider an analogy of industry performance in an area with almost identical market characteristics -- soft drinks. The soft-drink industry is composed of a three-tier marketing system but, more importantly, it received legislative approbation of exclusive territories in 1980. It is important to investigate the relative performance of that industry before and after "trans-shipping" and intrabrand competition was disallowed for distributors within defined geographic markets.

The Soft Drink Industry: Performance with Exclusive Territories

Soft drinks, since the rise of national markets, have been characterized by a similar distributional-evolutionary marketing process as beer. While the analogy between beer and soft drinks is not perfect (e.g., in the soft drink case syrup, rather than manufactured soda, is sold to bottler-distributors, and soft drinks are not burdened by the plethora of taxes and regulations imposed on beer), the industry's performance is clearly relevant to the issue of legislative approbation of exclusive territories. The soft drink industry, prior to 1980 when Congress granted assurance of exclusive territories to soft drinks, was characterized by the same distribution system as beer, including the presence of efficiency-inhibiting "free-rider" effects.

Carbonated soft drinks, like beer, face intense competition from a broad rage of alternative beverage products. Bottled water, powdered soft drinks, tea, juices, coffee, and milk compete through price and marketing techniques with soft drinks. Some evidence suggests that products such as wine coolers and low-alcohol beer compete similarly with soft drinks. New entry into the beverage market -- a sure sign of competitive rivalry and efficient competitive market performance -- has been phenomenal. Over the period 1984-85, according to New Product News, almost 1200 new beverage products were introduced into the American market. (A breakdown of these products by characteristic is found in Table 2). More than one hundred new low-alcohol (wine and beer) products were introduced that year, which is not atypical of the kind of entry consistently observed in the beverage field for both alcoholic and non-alcoholic products.

Most important is the relative performance of the industry in terms of price and consumption since the institution of exclusive territories in 1980. Figure 4 shows the per capita consumption trends between 1975 and 1985 in soft drink sales (carbonated and non-carbonated) as compared to the trends in other beverage consumption. While sales of coffee and milk have declined in absolute terms, soft drink sales have sky-rocketed compared to beer and all other types of beverages. (Annual per capita consumption of soft drinks is anticipated to grow to over 55 gallons per capita in 1995 compared to about 45 gallons per capita in 1985).

In contrast to the comparison of cola price changes to price

TABLE 2: Product Introductions in the Beverage Market, 1984-85

	NUMBER	PERCENT
Carbonated	374	31.4
Non-Carbonated	816	68.6
Total	1190	100.0
Non-Alcohol	1085	91.2
Alcohol (low alcohol)	105	8.8
Total	1190	100.0

Source: "New Beverage Products 1984-1985" *New Product News*.

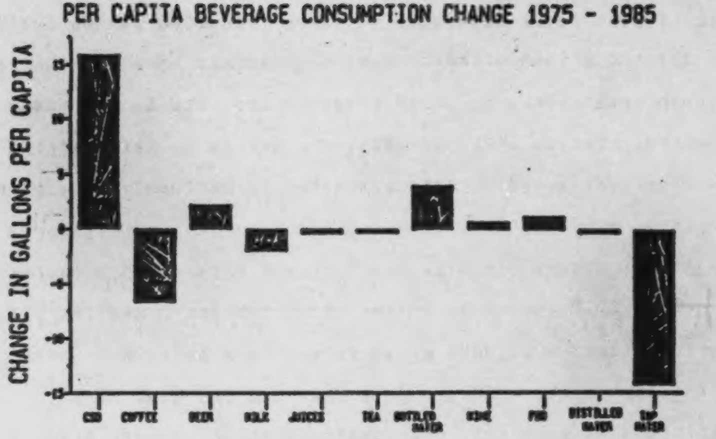

PER CAPITA BEVERAGE CONSUMPTION CHANGE 1975 - 1985
CHANGE IN GALLONS PER CAPITA
15
10
5
0
-5
-10
-15
CSD
COFFEE
BEER
MILK
JUICES
TEA
BOTTLED WATER
WINE
PSD
DISTILLED WATER
TAP WATER

FIGURE 4

changes of some other beverages over the 1968-1986 period (see Figure 3), the prices of carbonated soft drinks have risen at a much lower rate than many other beverage products in the post-1980 period. Betwen 1981 and 1985, the prices of soft drinks rose 4.1 percent based on data published by Nielsen.[11] The prices of competing products grew at a much faster rate, including powdered soft drinks (13.4 percent), fruit drinks (15.2 percent), fruit juice (21.8 percent), coffee (13.3 percent), and tea (17.6 percent). Relative to soft drink sales, beer sales have been declining during the 1980s, a fact that has led some beer manufacturers to move into other markets (such as soft drinks) with similar distribution channels.[12]

By any measure the relative performance of the soft drink industry since the legislative institution of exclusive territories in 1980 has been efficient and very positive in terms of consumer welfare. The overall strengthening of competitiveness through elimination of intrabrand competition and "free-riding" has created a brisk competitive environment characterized by easy entry of new products and brands. Evidence of lower price and higher consumption means that actual product entry and potential rivalry have created an economically efficient and welfare-enhancing product market in the soft drink industry.[13]

Relevance for the Malt Beverage Industry

Soft drink experiences teaches us that efficient performance is expected in similar cases such as malt beverages. In the case of soft drinks we have observed prices declining along with huge increases in the volume of soft drinks sold. Exclusive territories did not rout competition. If anything, they have created greater competition. Likewise, we expect to observe falling real prices in an efficient competitive beer marketing environment. These markets, we have argued, are created by conditions such as exclusive geographic territories (without "trans-shipping"). Such conditions are expected to promote interbrand competition, ease of entry, and enhanced consumer welfare in states where exclusive territories are mandated on beer distributors.

Competitiveness and Contestability in the Beverage Market. While some critics argue that concentration levels in both the beer and soft drink industries raise potential problems of monopolistic collusion, modern economic theory shows that both actual entry and potential entry will discipline the pricing behavior of industries with a few or even with one firm. Recently, economists William Baumol, John Panzar and Robert Willig have offered a contestability theory of market structure which stresses ease of entry and exit rather than the number of firms as the critical determinants of competitive outcomes in a market.[14] As we have seen, the number of breweries in the U.S. has been rising fairly rapidly in recent years, but there are a number of other important features of the beer industry and the beverage market that point to keen competitivenes and full contestability.

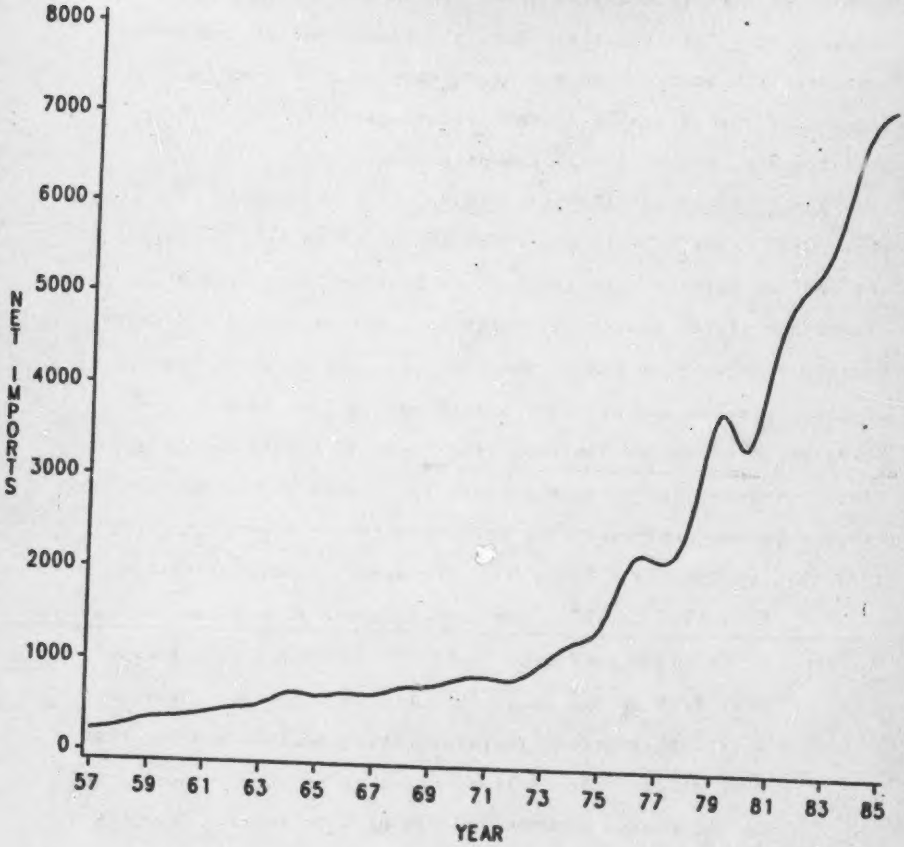
There are simply too many competitors in the beverage market, actual and potential, to suggest a lack of competition. If any beer manufacturer attempted to raise its prices to supracompetitive levels, it would lose a significant amount of sales to other beer and beverage companies. Higher than competitive returns would also signal strategic groups of beer producers to enter the market. Other recent developments in the beverage market are also relevant. For example, in the face of declining beer sales, distributors are searching for other beverage products to initiate within their distribution systems. Carbonated and non-carbonated beverages are natural products for entry in this regard. In 1986, Gary Truitt, Vice-President of International Marketing and Development at Adolph Coors Company, stated that with per capita sales of beer declining, "beer and liquor companies recognize their need to compete with non-alcoholic beverages such as bottled water and soft drinks." As a consequence, Coors "is looking for ways to grow and has considered entering the market with alternative beverage products" since "for a company in the beverage industry which is seeking to expand, like Coors, it is natural to consider alternative beverage products." Beer and soft drink distribution systems -- as evidenced by the growing number of distributors that handle both products -- are able to handle a myriad of competing products competitively and effectively. There seem to be no technological barriers to entry into the beverage market, including beer.

Even more dramatic is the actual and potential contestability represented by beer imports. Figure 5, which shows the net imports of beer into the U.S. between 1957 and 1985, is evidence of the foreign entry faced by U.S. beer manufacturers. In 1957, approximately 220 thousand 31-gallon barrels of beer on net were imported in the U.S. By 1985 net imports of beer to the U.S. market reached 7 million, 200 thousand 31-gallon barrels. The last decade has witnessed the most dramatic increase in net beer imports, a fact which reinforces the existence of entry contestability in the beer industry and in the overall beverage market.

The Michigan and Alabama Studies. Before turning to a formal econometric model of the price impact of exclusive territories in the beer industry across the U.S. in Section II, consider the experience of two states with regard to the impact of exclusive distribution on beer prices over the past two decades. (Excerpts of these studies may be found in Appendix III). In a study prepared by the Michigan Department of Public Health's Office of Substance Abuse Services, beer price and excise tax revenues were juxtaposed with inflation trends over the period 1967 through 1983 (see Table 3). The agency concluded that

> From 1967 to 1983, the overall price of consumer goods in Michigan increased nearly 300%. Disposable income rose from $2,913 to $9,725, a 230% increase. However, retail beer prices increased by only 220%, meaning that beer prices have declined relative to other products and to the amount of money people have to spend. Over time, beer prices have become comparable to or lower than prices for soft drinks and fruit juices.[15]

In constant dollar terms, a six-pack that cost $1.23 in 1967 cost only 91 cents in 1983. While lamenting a loss of over 65 million dollars in state beer tax revenues, the agency called the price decline "an enviable business achievement by beer



NET IMPORTS OF BEER : 1957-1985
(THOUSANDS OF 31 GALLON BARRELS)

SOURCE : BREWERS ALMANAC

FIGURE 5

TABLE 3: Beer Six-Pack Prices in Michigan : 1967-1983

YEAR	NOMINAL PRICE	1967 DOLLAR (REAL) PRICE	
1967	$ 1.23	$ 1.23	
1968	1.26	1.21	
1968	1.30	1.18	
1970	1.34	1.14	
1971	1.39	1.14	
1972	1.40	1.11	
1973	1.42	1.06	
1974	1.56	1.05	
1975	1.73	1.08	
1976	1.76	1.04	
1977	1.81	1.00	(exclusive territories law 1/1/77)
1978	1.97	1.01	
1979	2.36	1.08	
1980	2.59	1.02	
1981	2.73	.99	
1982	2.65	.92	
1983	2.71	.91	

manufacturers." This enviable achievement would not have been possible in an economically inefficient environment characterized by socially inefficient intrabrand rivalry. Such rivalry would have yielded higher real prices of beer in terms of quality diminution and service conjestion.

Another recent study confirms the fact that exclusive territories granted in the in the state of Alabama in 1984 have been associated with falling beer prices.[16] Data on both beer and wine were examined for the second quarter of 1984 (when the bill was passed) and again in the third quarter of 1986. The study concluded that overall beer prices fell by 11 cents per six pack over the period and that the results tend to support the view that primary competition exists between distributors of different brands of beer within territories, rather than between same-brand distributors competing between different territories.

The evidence from Michigan and Alabama, though suggestive, is fragmentary and could be the result of isolated experiences. More conclusive evidence of the economic efficiency of exclusive distributorships (those excluding trans-shipping) can only be offered within the context of a nationwide study of beer marketing.

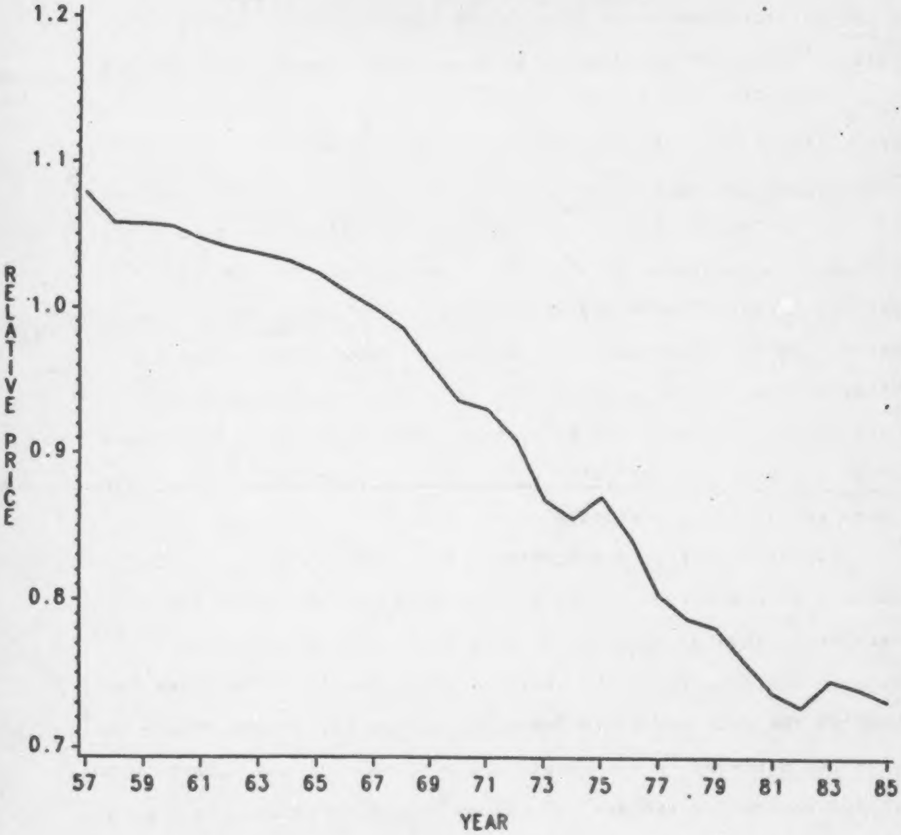
II. SOME AGGREGATE ASPECTS OF THE BEER INDUSTRY OVER TIME

Before turning to an empirical analysis of the effect of state-mandated exclusive distributor territories on retail beer prices, a view of the nationwide beer industry and beer consumers over the last three decades is in order. Both a descriptive view and a formal statistical analysis are presented.

Descriptive Analysis

As discussed earlier, and as Figure 3 indicated, retail beer prices rose by approximately 140 percent during the 1967-1986 period. However, this period was one of variable, yet persistent, general inflation in the U. S. economy. Beer prices, like any other prices, would be reasonably expected to increase during inflationary periods. Of importance, though, is not the nominal price of beer, but its price relative to the prices of all other goods and services available in the economy.

Figure 6 depicts the movement, from 1957 to 1985, of the price of beer in comparison to the average price of all goods and services. This measure of the relative price of beer is constructed by forming the ratio of the Consumer Price Index for beer to the Consumer Price Index for all goods. It therefore shows what has happened to the retail price of beer in comparison to the retail prices (on average) of all goods and services. As Figure 6 clearly indicates, retail beer prices have steadily declined since 1957. In 1957, average beer prices were about 1.08 times the average of all goods' and services' prices. By 1985 they were less than 75 percent of the average of all prices. This implies that, after adjusting for general price inflation, retail beer prices have declined by more than 30 percent since 1957.



THE RELATIVE PRICE OF BEER : 1957-1985
(1967 = 1.00)

SOURCE : BREWERS ALMANAC

FIGURE 6

This real price decline is even more startling in light of the data presented in Figure 7 and Figure 8. Figure 7 compares the trend over time of hourly wages in the beer industry with hourly wages rates paid in all food industries and in the manufacturing sector. Wage rates paid by firms in the beer industry have been consistently higher than in the other two sectors and, since the mid-1960s, have been growing more rapidly. In spite of the high and rapidly growing wage rate in this industry, relative retail beer prices nonetheless experienced the decline mentioned earlier.

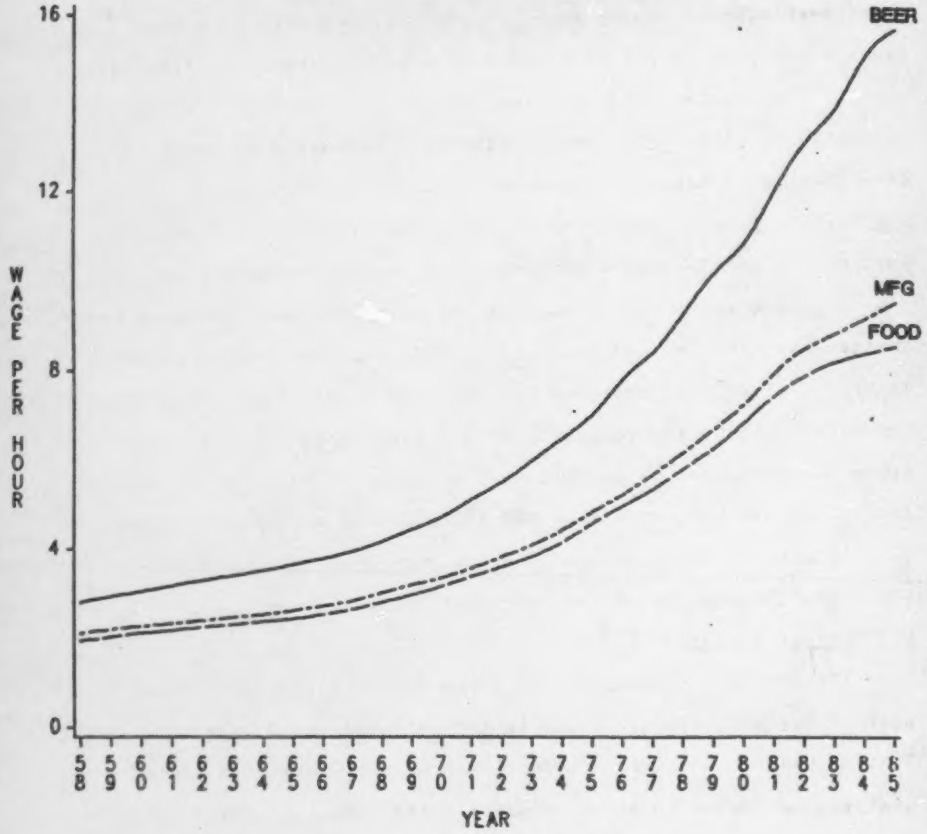
Figure 8 sketches how the tax burden on the beer industry has changed over the last 29 years. In 1957 total state plus federal direct taxes on beer amounted to just over $1 billion. By 1985 these taxes had risen to nearly $3 billion. Additionally, the state tax revenues are exclusive of any general sales or gross receipts taxes collected from the sale of beer at retail. Again, even though the tax burden on the industry rose dramatically over the period, the price of beer at retail steadily declined.

Statistical Analysis

The previous descriptive analysis paints a picture of retail beer prices steadily declining in inflation-adjusted terms over the last 30 years. However, a more formal and sophisticated method of analysis is needed in order to discern the extent to which various factors have influenced retail beer prices. The generally accepted, standard statistical technique of regression analysis is employed in this study in order to gauge the direction and size of these influences

A regression model or equation, such as those presented in

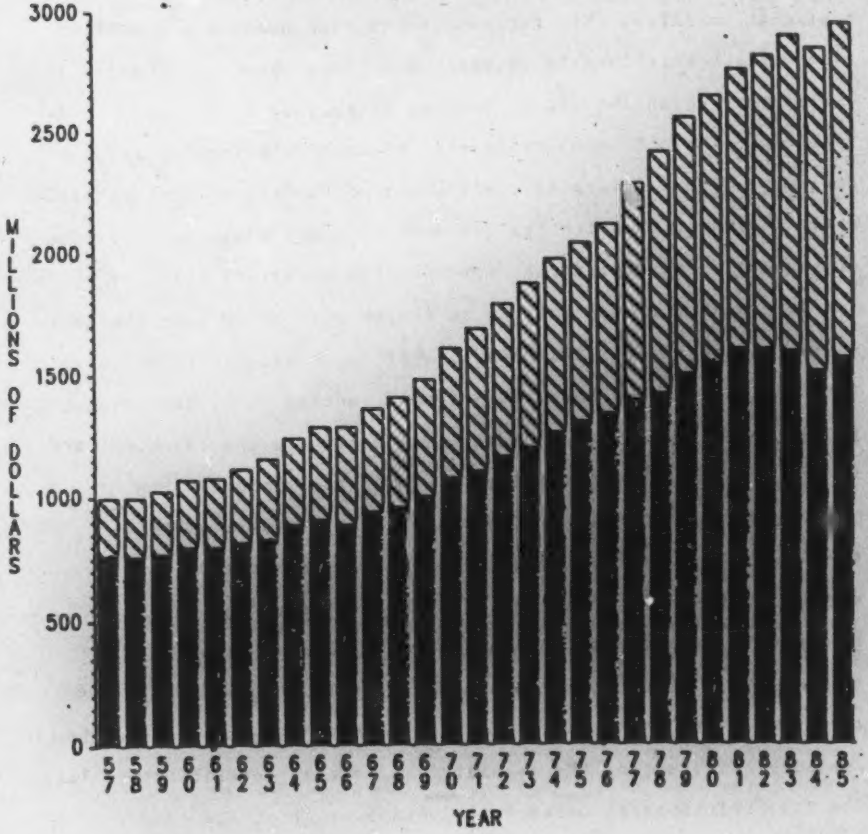
INDUSTRY WAGE RATES
BEER, ALL FOOD, AND MANUFACTURING : 1958-1985



SOURCE : BREWERS ALMANAC

FIGURE 7

FEDERAL AND STATE BEER TAX REVENUES : 1957-1985
(MILLIONS OF DOLLARS)



NOTE : FEDERAL REVENUES IN SOLID AREAS
STATE REVENUES IN ANGLED LINE AREAS

SOURCE : BREWERS ALMANAC

FIGURE 8

Table 4, shows how changes or differences in factors called explanatory variables affect some other variable, called a dependent variable. The regression equation assumes a specific cause-effect relationship between variables. That is, changes in explanatory variables cause changes, or responses, in the dependent variable. The direction and extent of this relationship is reflected in the estimated coefficient of the explanatory variable. Given the units in which the two variables are measured, the size of the estimated coefficient measures the number of units by which the dependent variable changes in response to a one unit change in the explanatory variable. The sign of the coefficient indicates the direction of the cause-effect relationship. Negative signs indicate an inverse relationship exists between the dependent and explanatory variable, positive signs a direct relationship.

We are also interested in knowing whether the estimated coefficient reflects the true relationship that exists between variables or if the estimate is merely the result of chance or random occurrence. Statistical theory allows us to make probabilistic statements about which of these two possibilities is the case. The "t-statistic" is used to make statements about how confident we are that the estimated regression coefficient reflects the true relationship between the variables, that the true coefficient is not zero (a zero coefficient indicates that there is no cause-effect relation between the explanatory and dependent variable). Large t-statistics (2.0 or greater) suggest that it is quite unlikely that the true coefficient is zero, that it is very likely that the estimated coefficient actually reflects the true relationship.

How likely or unlikely we are that the estimate mirrors the actual relationship revolves around the "level of significance." The level of significance is the probability, or chance, of estimating a non-zero coefficient when in fact the true coefficient is zero. Because we want to minimize the probability of incorrectly stating that a relationship exists when in fact it does not, traditional levels of significance are quite low (10% or lower). Thus, for example, the statement that the estimated coefficient is "statistically significant" or just "significant" at the 5% level means that we stand at most a 5% chance of being wrong in stating that the estimated coefficient reflects the true relationship between the two variables. To say that an estimate is "insignificant" means that, in all likelihood, the estimate is a result of random occurrence and that the true coefficient is zero, that there is no cause-effect relationship between the explanatory and dependent variable.

If it is assumed that prices have declined at a constant rate over this period, a simple time trend regression model can provide insight into the statistical significance of the decline. The estimated time trend regression model, employing annual data from 1957 to 1985, is given by equation 1 in Table 4. This equation clearly shows the statistically significant downward trend in real beer prices. The estimated coefficient indicates that real beer prices have fallen at a rate of about 1.6 percent per year, and that this rate of decline cannot be attributed to chance.

While equation 1 suggests a significant downward trend in the

TABLE 4

t - statistics in parentheses

	Equation 1	Equation 2	Equation 3	Equdtion 4
Dependent Variable	Relative Price	Relative Price	Relative Price	Per Capita Consumption
Estimation Method	OLS	OLS	TSLS	OLS
Explanatory Variables				
Constant	0.1368***	4.3100***	4.4581***	-0.8476
	(12.75)	(5.52)	(5.52)	(1.38)
Time Trend	-0.0159***	-0.0092***	-0.0088***	-0.0011***
	(25.51)	(3.85)	(3.57)	(3.15)
Aggregate Consumption		-0.5641***	-0.5794***	
		(7.88)	(7.77)	
Aggregate Real Income		0.3690***	0.3716***	
		(8.17)	(8.20)	
Per Capita Real Income				0.5020***
				(6.47)
Relative Price of Beer				-1.2127***
				(7.26)
R^2	0.96	0.99	0.99	0.98
F-Statistic	650.90***	1052.72***	1050.78***	514.57***
D-W Statistic		1.70	1.71	1.52

*** Denotes significance at the 1% level.

Note : Relative price is the ratio of the beer component of the Consumer Price Index to the All Items Consumer Price Index. Aggregate real income is disposable income deflated by the All Items Consumer Price Index. Per capita real income is aggregate real income divided by the population age 16 and over. Consumption figures reflect net imports. All variables (except the time trend) have been converted to their natural logarithms.

real price of beer in the United States, it would be informative to separate out the effects of factors which do not influence the trend per se. For example, filtering out the effects of rising real incomes on beer demand, and therefore price, would provide a better picture of the price trend.

Equation 2 presents the statistical results obtained by adding aggregate consumption and real disposable income to equation 1. Clearly, higher aggregate real income, through its effect on beer demand, tends to raise relative price. A one percent rise in real disposable income causes a 0.37 percent increase in the relative price of beer. The time trend shows that, after adjusting for consumption and real income, real beer prices have exhibited a statistically significance downward trend of about 0.9 percent per year. In all likelihood, this downward trend is due to improved efficiency in the industry. The aggregate consumption coefficient indicates that a 10 percent (supply induced) increase in output decreases real beer prices by 5.6 percent. All estimated coefficients are statistically significant at the 1 percent level and all of the summary statistics support the validity and relevance of the model estimates.

The possibility exists that the Ordinary Least Squares (OLS) estimation method employed to estimate equation 2 may be inappropriate and yield systematically misleading and unreliable estimates. To examine this possibility, the Reset Test F-Statistic for equation 2 was computed.[17] This test statistic ($F_{3,32}$ = 2.19) indicates OLS to be an appropriate estimation technique for equation 2. As a further check, a Two Stage Least Squares (TSLS) method was used to re-estimate equation 2, with results given by equation 3 in Table 4. The close similarity of the estimates in the two equations buttresses the Reset test results.

Before leaving the aggregate analysis of the national beer industry, it would be instructive to consider the the factors that determine beer consumption, or the demand for beer. Equation 4 in Table 4 estimates the relationship between per capita consumption and the factors which determine per capita consumption. This regression equation can be viewed as an estimate of the national demand for beer, but on a per capita basis.

Equation 4 indicates that per capita beer consumption increases as per capita real disposable income rises, but by less in percentage terms. The estimated coefficient indicates that a one percent increase in real income increases beer consumption by one-half of one percent. Increases in price, as theory predicts, lead to diminished beer consumption. However, the popular notion that beer consumers are not very responsive to price changes with respect to the amount they consume is not supported by the data. Equation 4 indicates that a one percent rise in price induces a greater than one percent decline in consumption (a 1.2 percent decline). The result clearly shows that beer consumers are not a captive audience. This relatively large price sensitivity is due to the large (and increasing) number of substitutes in the beverage market, of which beer is only one. This notion is supported by the negative time trend coefficient on per capita consumption. Adjusting for relative price and real income, per capita beer consumption is seen to be declining at about a one percent per year rate. This is also indicative of a growing number of competing substitutes for beer in the beverage market.

An aggregate historical examination of beer prices and related features of the industry, including consumer demand, reveals important trends. These features, while important, cannot detail the empirical impact of differences in industry characteristics across states. We therefore turn to cross-state analysis in section III.

III. EXCLUSIVE TERRITORIES AND BEER PRICES : ECONOMETRIC ANALYSIS

This section presents the findings of a nationwide econometric model developed to gauge the effects that state-granted exclusive territory legislation have in the national beer industry. As discussed above, some have argued that exclusive territorial franchises of beer distributors are a form of vertical restraint designed to raise price by creating monopoly power, while we have argued that exclusive franchises are a method by which distributors can monitor product quality at a relatively low cost as well as provide consumers with a higher quality of both product and service. These two hypotheses are at odds, each predicting different effects of exclusive franchises on the market price and consumption of beer. The monopoly power arguments suggest that prices will be higher in states granting exclusive franchises than prices in states where exclusivity is not mandated. The improved quality and service arguments predict that prices will not be higher and may actually be lower in exclusive franchise states.

In order to resolve the issue of exactly how territorial exclusivity in distribution affects market variables such as price, it is necessary to specify the major economic factors which interact to determine price. The first part of this section presents the methodology employed in selecting relevant economic variables and constructing an empirical model of the market price of beer. Next, the data employed to measure these relevant economic variables are described and discussed. A presentation and interpretation of statistical results follow.

Methodology

The national beer industry is qualitatively similar to any other industry. That is, the basic tools of economics can be applied to the beer industry to discover the fundamental economic factors which interact to determine the price of beer in each of the fifty states.[18] Because of the basic structure of the industry (geographically dispersed competitive breweries, competitive input markets, and so on), differences in beer prices across states will reflect state-specific differences in supplier and demander characteristics, as well as differences in the economic and legal environment in which the industry operates.

Economic theory suggests that the market price of beer in each state is determined by the interaction of demanders and suppliers *given the economic environment under which the market functions*. In order to properly test a hypothesis concerning the effect of exclusive franchises on the market price of beer, the effects of major supply and demand determinants as well as the consequences of the presence or absence of exclusive territories must be accounted for.

Demand Factors. While a large number of factors could possibly be cited as influencing the demand for beer by residents of the fifty states, economic theory, as well as data limitations, dictate that only the major demand determinants be analyzed. These factors generally differ across the states, and are sources of price differences between the states. Included among these variables are consumers'total real disposable income in each state and the real price of a closely related good, wine. In this study, real variables are variables which have been adjusted for general cost-of-living differences across states.

Economic theory does not specifically predict either the direction or the degree of influence on the demand for and the market price of beer that the prices of related goods have. Whether the price of wine, soft drinks, or distilled spirits significantly influences the price of beer positively or negatively is an empirical issue. Though one may reasonably expect greater demand for beer and higher beer prices to be associated with higher real consumer income, economic theory allows for the opposite to be the case. Again, the relationship between consumer real income and the market price of beer is a statistical issue.

Supply Factors. In explaining price differences across the states, factors which affect supply and which differ across the states must be employed. This study focuses on the presence or absence of state mandated exclusive distributor franchises and the degree of state-imposed advertising restrictions on the marketing of beer. Clearly, it is possible that the presence or absence of state mandated exclusive distributor territories affects the supply of beer. The effect on the market price of beer of exclusive franchises is an empirical issue.

Much recent literature in economics indicates that state-imposed restrictions on retail advertising are likely to affect supply, and therefore to influence market price and consumption. Such restrictions influence supply in that they act to curb one means of competition among retailers.[19] Since these restrictions vary across the states, they are candidates for explaining differences in prices between states. To the extent that advertising restrictions diminish competition among retailers, it is expected that retail prices will be higher in states with more severe restrictions.

Other factors (transportation costs, land prices, and so on) will influence supply and retail price. However, one of the primary factors which affects supply is the wage rate paid to labor. As wage rates directly affect production costs, it is expected that states characterized by high average real wage rates will also experience a higher real market price of beer.

Market Characteristics. The concept of full price, as explained earlier, is not only appealing to economists but to anybody who has ever driven to a store and stood in a checkout line. Its implication for this study is that after having adjusted for differences in consumption, consumer income, the prices of closely related goods, exclusive distributor territories, advertising restrictions, general cost-of-living differences, and other supply factors, the money price of beer among the states could still reasonably be expected to differ. In order to isolate the effect of territorial exclusivity on price, factors which influence consumers' transaction costs associated with purchases must be expressly accounted for.

One such element involves the physical ability of retail outlets to service customers. The smaller the capacity of retailers to service customers, the greater will be congestion in stores at any given time, and the greater the transaction cost component of full price. Adjusting for other factors and given a full price equilibrium across states, greater service congestion will result in a lower money price compensating for greater transactions costs.20

Measurement of Relevant Variables

Retail Market Price and Quantity of Beer. The average market retail price per gallon and the quantity (millions of gallons) of beer sold in each state in 1984 were obtained from figures published in Beverage World. In order to avoid bias due to general cost-of-living differences across states, the retail price of beer in each state was deflated by the Bureau of Labor Statistics' regional Consumer Price Index-All Items. Beer prices are thus measured in real terms.

Consumer Income. Consumer income in each state (billions of dollars) is measured as the product of per capita disposable income and population in 1984, found in Survey of Current Business and State and Metropolitan Area Data Book: 1986, respectively. Real state income was calculated by deflating by the regional Consumer Price Index-All Items. The use of real state disposable income controls for the effects of general cost-of-living differences among states.

Price of a Related Good. The average retail price of wine in each of the fifty states during 1984 was obtained from Beverage World and converted to real prices by deflating by the regional Consumer Price Index-All Items.

Exclusivity. The presence or absence of state-mandated exclusive distributor territories is accounted for by a dummy variable. In regression results presented in Tables 5, 6,and 7 those states which forbid exclusive territories and those states whose laws either allow or are silent with respect to territorial exclusivity are treated as non-exclusive. Those which mandate exclusive territories are categorized as exclusive in these tables.

In regression results contained in Table 8, exclusivity is accounted for in a slightly different, but more realistic fashion. Indiana was the only state which expressly forbade exclusive distributor territories in 1984. With all other states' laws either expressly permitting or silent about, and thereby permitting by default, exclusive territories, it is reasonable to conclude that all states save Indiana were, to some degree, exclusive in 1984. The statistical results presented in Table 8 assume all state were exclusive except Indiana.

Advertising Restrictions. State advertising restrictions at the retail level apply to four categories of advertising; newspapers and magazines, radio and television, exterior signs, and interior window signs viewable from the exterior of the establishment. The presence of these restrictions is accounted for with dummy variables. States were coded as not having a restriction if state law either permitted without restriction or had no provisions concerning an advertising method.

Additionally, a Schmandt-Stevens[21] index of advertising restrictions was constructed to capture the overall effect of the extent of types of restrictions on price. The Schmandt-Stevens index is constructed by summing relevant dummy variables. Data on restrictions were found in the United States Brewers Association's *Special Information Book*.

Labor Costs. The average manufacturing wage rate, obtained from State and Metropolitan Area Data Book: 1986, deflated by the regional Consumer Price Index-All Items, is employed to measure the average unit labor cost facing firms.

Congestion-Service Capacity and Time Costs. The study measures the average level of congestion in the market through use of the ratio of population to the total number of retail food, eating, and drinking establishments in a state. Retail establishment data by state were obtained from State and Metropolitan Area Data Book: 1986. Higher ratios of population to the number of retail establishments (more potential customers per retail outlet per unit of time) indicate lessened capacity to service customers which yields greater congestion, and vice versa. Thus, a negative relation between money price and the ratio of potential customers per retail outlet is expected.

Empirical Results

Tables 5, and 6 present the results of estimating the effects of the above variables on the real price of beer in 49 states under the assumption that only states which explicitly mandate exclusivity are considered exclusive. The state of Washington was excluded from the sample due to the unavailability of data on the average hourly manufacturing wage rate in 1984. In Table 7, regressions that exclude the real wage and thus include data for Washington are presented. As can be seen by comparing equations 1 and 3 in Table 5 to their counterparts in Table 7, the estimated signs of all remaining variables do not change and their significance levels very only marginally. As such, the significance and explanatory power of regression models deleting the observation for the state of Washington should be considered quite valid.

Table 5 presents empirical results obtained from estimating the effects on the real retail price of beer of the variables discussed earlier. Equations 1 and 3 were estimated using a single equation, Ordinary Least Squares (OLS) regression technique. Equation 1 differs from equation 3 solely in the manner in which the advertising restrictions index was formed. Index 1 incorporates the effects of restrictions on newspaper and magazine advertising, exterior sign advertising, and interior sign advertising. Index 2 accounts for these three types of restrictions plus restrictions on radio and television advertising.

Equations 1 and 3 show all estimates of the theoretical model variables to be of the predicted sign (where relevant) and to be statistically significant (one-tail tests were employed where appropriate) at the 5% level or better _except for the measure of territorial exclusivity_. In both equations, the measure of exclusivity is _negative_ but not statistically different from zero. A strict interpretation of the data indicates that retail beer prices are no higher in states which mandate exclusive territories than in other states once the effects of other relevant factors on price are accounted for. In a weaker sense, the results suggest _lower_ prices in states which mandate exclusive territories.[22] Clearly, if exclusive distributorships were a method of monopolizing industries and charging retailers higher prices, competitive retailers would pass along (to some degree) these

TABLE 5

Dependent Variable: Real retail money price of beer (per gallon)
t - statistics in parentheses.

Estimation Method	OLS	TSLS	OLS	TSLS
Explanatory Variable	Equation 1	Equation 2	Equation 3	Equation 4
Constant	2.5700***	2.5618***	2.5367***	2.5266***
	(5.6404)	(5.6083)	(5.4548)	(5.4152)
Exclusivity	-0.0293	-0.0337	-0.0404	-0.0456
	(0.4190)	(0.4755)	(0.5546)	(0.6194)
Advertising Restriction Index 1	0.0772***	0.0772***		
	(2.8036)	(2.7991)		
Advertising Restriction Index 2			0.0561***	0.0558***
			(2.4900)	(2.4698)
Consumption	-0.0028***	-0.0024*	-0.0029***	-0.0024*
	(2.3675)	(1.5556)	(2.3979)	(1.5001)
Real Income	0.0088**	0.0074	0.0092**	0.0073
	(2.1817)	(1.4330)	(2.2266)	(1.3907)
Real Price of Wine	0.0853**	0.0857**	0.0900**	0.0904**
	(2.4534)	(2.4582)	(2.5181)	(2.5205)
Service Congestion	-1.1634**	-1.1621**	-1.1443**	-1.1416**
	(2.2464)	(2.2403)	(2.1714)	(2.1608)
Real Wage	0.1003**	0.1010**	0.1000**	0.1010**
	(2.1524)	(2.1630)	(2.1096)	(2.1224)
R^2	0.39		0.37	
F-Statistic	3.77***	3.74***	3.44***	3.39***
Reset Test F-Statistic	0.96		0.93	

*** Denotes significance at the 1% level.
** Denotes significance at the 5% level.
* Denotes significance at the 10% level.

TABLE 6

Dependent Variable: Real retail money price of beer (per gallon)
t - statistics in parentheses.

Estimation Method	OLS	OLS
Explanatory Variable		
Constant	3.1701*** (8.6342)	3.1318*** (8.3594)
Exclusivity	-0.0197 (0.2684)	-0.0324 (0.4246)
Advertising Restriction Index 1	0.0801*** (2.7534)	
Advertising Restriction Index 2		0.0591** (2.4944)
Consumption	-0.0028** (2.2585)	-0.0029** (2.3001)
Real Income	0.0093** (2.1938)	0.0097** (2.2469)
Real Price of Wine	0.0808** (2.2041)	0.0860** (2.2889)
Service Congestion	-1.2731** (2.3414)	-1.2563** (2.2791)
R^2	0.31	0.29
F-Statistic	3.21**	2.93**

*** Denotes significance at the 1% level.
** Denotes significance at the 5% level.
* Denotes significance at the 10% level.

higher input prices to consumers. The data reject this interpretation.

The possibility exists that OLS is an inappropriate estimation method. Due to the fact that price and consumption are simultaneously determined in markets, including consumption as an explanatory variable in the price equation may lead to biased estimates. The Reset Test F-Statistic tests for the presence of this bias, as well as other forms of specification error. In both equations 1 and 3 the Reset Test F-Statistics indicate the absence of any specification error, and the appropriateness of the OLS estimation technique. As a further check, equations 2 and 4 were estimated with a Two Stage Least Squares (TSLS) method. The TSLS estimation method corrects for this type of specification error, if present. Comparing equation 1 (OLS) with 2 (TSLS) and 3 (OLS) with 4 (TSLS) reinforces the conclusion of the absence of specification error in equations 1 and 3. In each pair of equations, the estimated coefficients are equal in sign and similar in magnitude. In all subsequent tables, regression models are estimated with an OLS technique.

The idea of a full price equilibrium across states is reinforced by the signs of the estimated coefficient on service congestion. The negative coefficient of the service congestion variable suggests that higher levels of congestion, which raise consumer transactions costs, are associated with lower real money prices.

Equations 1 and 3 in Table 5 uncover an important source of artificially high retail beer prices. In each equation, the

TABLE 7

Dependent Variable: Real retail money price of beer (per gallon)
t - statistics in parentheses.

Estimation Method	OLS	OLS	OLS	OLS
Explanatory Variable				
Constant	2.7018*** (5.8324)	2.5538*** (5.4484)	2.5463*** (5.3723)	2.5824*** (5.1788)
Exclusivity	-0.0471 (0.6381)	0.0063 (0.0905)	-0.0136 (0.1895)	-0.0144 (0.1772)
Consumption	-0.0023* (1.8176)	-0.0028** (2.3248)	-0.0033** (2.6132)	-0.0029** (2.2634)
Real Income	0.0068 (1.6133)	0.0090** (2.1533)	0.0105** (2.4743)	0.0094** (3.1302)
Real Price of Wine	0.0859** (2.4191)	0.0761** (2.1461)	0.0842** (2.3322)	0.0835** (2.1349)
Service Congestion	-1.2392** (2.3103)	-0.9531* (1.8123)	-1.1411** (2.1208)	-1.0013* (1.7976)
Real Wage	0.0863* (2.4812)	0.1028** (2.1499)	0.1119** (2.3182)	0.1021** (2.0240)
Print Media Restrictions	0.1869* (2.4812)			
Exterior Sign Restrictions		0.1573** (2.3188)		
Window Sign Restrictions			0.1537** (3.1308)	
Radio & TV Restrictions				0.0714 (0.8739)
R2	0.37	0.36	0.35	0.29
F-Statistic	3.44***	3.28***	3.12***	2.37***

*** Denotes significance at the 1% level.
** Denotes significance at the 5% level.
* Denotes significance at the 10% level.

advertising restriction index indicates that beer prices are higher, given other factors, the greater the number of ways in which state law prohibits and restricts retail competition through advertising. This is so regardless of which index is employed. The estimated coefficients indicate that the imposition of one additional kind of advertising restriction raises beer prices by between 5 and 8 cents per gallon in terms of 1984 prices (5.5 to 8.5 cents per gallon in 1987 dollars).

Table 7 reports regression results obtained by decomposing advertising restriction index 2 into its four components. As can be seen, restrictions and prohibitions on exterior signs and interior window signs which can be seen from the exterior each significantly raise retail beer prices by about 15 cents per gallon in 1984 dollars, 16.2 cents per gallon in 1987 dollars. Newspaper and magazine advertising restrictions raise price approximately 18 cents per gallon. Restrictions on radio and television advertising appear to have no statistically significant influence on retail price. This is not surprising in that states cannot prevent national broadcasters from transmitting nationally-aired beer commercials into the state. Thus, even in states with broadcast restrictions, a significant amount of beer advertising still penetrates the market.

Equations in Table 8 represent results obtained from estimating equations 1 and 3 from Table 5 under the assumption that all states except Indiana are states characterized by some degree of exclusivity with respect to distributor territories. Recall that in 1984 Indiana was the only state in the country that

TABLE 8

Dependent Variable: Real retail money price of beer (per gallon)
t - statistics in parentheses.

Explanatory Variable		
Constant	2.9696***	3.0079***
	(5.5988)	(5.6194)
Exclusivity	-0.3136a	-0.3667a
	(1.3452)	(1.5680)
Advertising Restriction Index 1	0.0695***	
	(2.6167)	
Advertising Restriction Index 2		0.0504**
		(2.4025)
Consumption	-0.0029**	-0.0030**
	(2.5378)	(2.5991)
Real Income	0.0093**	0.0097**
	(2.3778)	(2.4564)
Real Price of Wine	0.0849**	0.0889**
	(2.5128)	(2.5841)
Service Congestion	-1.2467**	-1.2522**
	(2.4572)	(2.4335)
Real Wage	0.0901*	0.0881*
	(1.9410)	(1.8776)
R^2	0.42	0.40
F-Statistic	4.15**	3.93**

***Denotes significance at the 1% level.
** Denotes significance at the 5% level.
* Denotes significance at the 10% level.
a Denotes significance at the 20% level.

prohibited the exclusive distributor relationship. Note that under this alternate empirical definition of exclusivity, the estimated coefficients of all remaining price determinants are statistically significant and of theoretically predicted sign (where appropriate). They are also very similar in magnitude to the estimated coefficients obtained in regression models which employed the first, broader empirical measurement of exclusivity. The fact that the signs, magnitudes, and significance of the estimates do not vary much as the measurement of state exclusivity changes points to their importance as variables explaining the retail price of beer. Clearly, the exclusion of such relevant variables from any statistical model purporting to explain retail beer prices would be a grave specification error.

More importantly, note the estimates of the effects of both exclusivity and advertising restrictions on retail price contained in Table 8. In these specifications advertising restrictions again act to raise retail beer prices, as evidenced by their positive estimated coefficients. In these two equations the exclusivity variable captures the effect on the retail price of beer of allowing exclusive arrangements, either directly through explicit legislation or indirectly through no prohibitions. It effectively permits the comparison of retail price in Indiana with the remaining states in the sample. The estimated coefficient indicates that retail beer prices were, in terms of 1984 dollars, from 31 to 37 cents per gallon lower (33.5 to 40 cents per gallon in 1987 dollars) in states allowing exclusive territories than in the one state which prohibited such arrangements, Indiana. Note also that the estimate is statistically significant at the 20 percent level. Again, the evidence points to a price lowering effect of exclusivity in distributor territories.

IV. CONCLUSION

The empirical results presented in this study lead to strong, unambiguous conclusions. After correcting for various market effects, the real price of beer has fallen significantly over the past three decades. Moreover, the effects concerning the impact of exclusive distributorships in the Alabama study are affirmed for the nation as a whole.

We conclude from our study that competition is vibrant in the beer industry--both interbrand competition and competition within the broader beverage market. Higher prices are the result artificial constraintsa upon the competitive process, and are not the result of exclusive arrangements between manufacturers and their distributors. State-mandated exclusive distributor territories lead to lower retail beer prices. There is certainly no evidence suggesting that exclusive territories lead to higher retail prices. Market forces such as higher real incomes and higer prices of close substitutes (wine), result in higher beer prices as they likely would in any other market. State-imposed advertising restrictions, on the other hand, artificially raise retail price through their effects in reducing competition.

FOOTNOTES

[1] Steve L. Barsby & Associates, Inc., "The Regulatory and Economic Basis of Franchised Wholesaling in the Alcohol Beverage Industry," (1983), p. iii. Also see the Statement of Steve L. Barsby on the economics of exclusive territories, "The Malt Beverage Interbrand Competition Act," Hearings before the Committee on the Judiciary, U. S. Senate (1984) (Washington, D.C.: U.S. Government Printing Office, 1984), pp. 54-74.

[2] For legal analyses of restricted distribution, see two essays by Richard A. Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality," University of Chicago Law Review 48 (Winter, 1981), pp. 6-26, and "The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision," University of Chicago Law Review 45 (Fall, 1977), pp. 1-20. For an interesting economic defense of exclusive dealing (in addition to restricted distribution) see Howard P. Marvel, "Exclusive Dealing," Journal of Law and Economics 25 (April 1982), pp. 1-25.

[3] This position is, in essense, that of the Department of Justice: Statement of William F. Baxter, Assistant Attorney General, Antitrust Division, before the Subcommittee on Antitrust and Restraints of Trade Activities Affecting Small Business (Committee on Small Busines), H.R., September 9, 1982.

[4] "Malt Beverage Interbrand Competition Act," Hearings before the Subcommittee on Monopolies and Commercial Law on H.R. 3269

(1982) (Washington, D.C.: U.S. Government Printing Office, 1982), pp. 2-3.

[5] Kenneth J. Hatten and Dan E. Schendel, "Heterogeneity Within an Industry: Firm Conduct in the U.S. Brewing Industry," Journal of Industrial Economics (December 1977), pp. 97-113.

[6] Statement of William Young, "The Malt Beverage Interbrand Competition Act," Hearings before the Committee on the Judiciary, U. S. Senate (1984) (Washington, D.C.: U.S. Government Printing Office, 1984), p. 84.

[7] Evidence of intense rivalry is provided in an exhaustive report to the Federal Trade Commission on the brewing industry by Charles F. Keithahn, The Brewing Industry (Washington, D.C.: Staff Report of the Bureau of Economics, Federal Trade Commission, December, 1978). Keithahn supported the case with evidence of strong interbrand rivalry, a lack of brand loyalty, and the strength and market position of regional competitors (see Keithahn, pp. 130-135). More recently, William J. Lynk subjected two competing explanations for interpreting rising concentration in the beer industry. (See "Interpreting Rising Concentration: The Case of Beer," Journal of Business 57 (1984), pp. 43-55). Lynk demonstrates, in formal tests of the empirical evidence, that competition, not anticompetitive exclusion of smaller brewers, is the better hypothesis for explaining changes in industry structure.

[8] Statement of William Young, "The Malt Beverage Interbrand Competition Act," p. 85.

[9] [Another example of the free rider: New York bottle law]

[10] Statement of William Young, "The Malt Beverage Interbrand Competition Act," p. 85.

[11] Nielsen Food Store Sales (1986).

[12] The blurring of traditional distinctions between alcoholic and non-alcoholic products, such as wine coolers has also led an increasing number of beer distributors to move into new beverage products.

[13] Our conclusions relating to profit and other performance in the soft drink industry and the beverage market overturn those drawn from largely anecdotal evidence by Mark N. Cooper (The Costs to Consumers of Exclusive Franchising: The Case of Malt Beverages, Washington, D.C.: Consumer Federation of America, September, 1986). We contrast our results with Cooper's in Appendix I of this paper.

[14] See William Baumol, John C. Panzar and Robert D. Willig, Contestable Markets and The Theory of Industry Structure (New York: Harcourt Brace Jovanovich, 1982) and E. F. Fama and A. B. Laffer, "The Number of Firms and Competition," American Economic Review, 62 (September 1972), pp. 670-674.

[15] "An Analysis of Michigan Beer Prices and Beer Revenues, 1967-1983," (Michigan Department of Public Health, Office of Substance Abuse Services, 1985), p. 5.

[16] Philip Gregorowicz, Charles Ileggi, and Wayne Lacy, "The Economic Impact of the Beer and Wine Industries on the Alabama Economy," (Montgomery, Alabama: Auburn University at Montgomery, January, 1987).

[17] For a detailed description of the Reset test see J.B. Ramsey, "Tests for Specification Error in Classical Linear Least Squares Analysis," *Journal of the Royal Statistical Society*, series B, no. 3, (1969), pp. 35-72, and J.B. Ramsey and P. Schmidt, "Some Further Results on the Use of OLS and BLUS Residuals in Specification Error Tests," *Journal of the American Statistical Association* (June, 1976), pp. 389-390.

[18] We do not intend to imply that a state is necessarily the proper or relevant geographic measure of a market area for beer. However, because of such factors as state-mandated exclusive distributional territories and state-imposed advertising restrictions, average beer prices could be reasonable expected to differ among states. For this reason, as well as the manner in which data are reported, our statistical analysis divides the country into "statewide" market areas.

[19] The classic research in this area is Lee Benham's "The Effect of Advertising on the Price of Eyeglasses," *Journal of Law and Economics* 15 (October, 1972), pp. 337-352. Benham showed conclusively that optometrists' retail advertising restrictions raised the prices of eyeglasses and eyecare above what they would have been in the absence of the restrictions. John F. Cady's

Restricted Advertising and Competition: The Case of Retail Drugs (Washington, D.C.: American Enterprise Institute, 1976) also finds retail advertising restrictions increased prices of over-the-counter and prescription drugs without any concomitant increase in the quality of service of retail suppliers. Thom Kelly and Alex Maurizi demonstrate in *Prices and Consumer Information: The Benefits from Posting Retail Gasoline Prices* (Washington, D.C.: American Enterprise Institute, 1978) that gasoline prices are significantly higher, after adjusting for other factors, in areas which prohibit price posting which is a form of advertising.

[20] The full price of any good is the sum of its money price, p, and the value of time consumers spend in purchasing the product, wt, where transaction time, t, is valued at the average consumer's unit time cost, w. For example, suppose that the money price of a six-pack of beer is $2 and that the average consumer, who earns, say, $6 per hour spends thirty minutes in traveling to the nearest retailer, making his purchase, and returning home. The full price of the six-pack is thus $2 plus $6 times one-half hour, or a total of $5. Equilibrium requires that, given other factors, the full price of beer be the same across states. But this equilibrium can be maintained by any of a number of combinations of money price and transaction cost value. If transaction costs in a state were higher than $3, for instance, either because transaction time were longer or alternative time costs were higher, equilibrium would be maintained by *lower* money prices of beer. By the same token,

lower transaction costs would be associated with higher money prices. These considerations provide the basis for our expectation that money prices and service congestion will be inversely related.

[21] For a detailed explanation of the construction and use of this type of index, see H.J. Schmandt and G.R. Stephens, "Measuring Municipal Output," National Tax Journal 13 (December, 1960), pp. 369-376.

[22] The strict interpretation of the results requires that we use standard significance levels. Since the t-statistics on exclusivity are so small, a conclusion that exclusivity lowers price would stand a relatively large chance (above 30 percent) of being incorrect. However, if we were willing to take this higher risk, we could legitimately draw this conclusion. It is this higher risk of being wrong that makes this conclusion "weaker" in a statistical sense. Interestingly, a statement that exclusivity raises price would stand at minimum a 70 percent chance of being incorrect on the basis of our results.

[23] Mark N. Cooper, The Costs to Consumers of Exclusive Franchising: The Case of Malt Beverages, (Washington, D.C.: Consumer Federation of America, September, 1986).

[24] Ibid., p. 36

APPENDIX I. COMPARATIVE EMPIRICAL RESULTS

In a position paper written for the Consumer Federation of America,[23] Dr. Mark N. Cooper produced a nationwide econometric study of the malt beverage industry for the years 1981 to 1984. On the basis of this statistical study, Dr. Cooper concludes:

> The data *strongly* supports the argument that exclusive territory laws are not imposed in the interest of efficiency. In every specification, the existence of exclusive territories is associated with higher prices and lower consumption (emphasis ours).[24]

We take issue with his findings on the grounds that Dr. Cooper's statistical methodology, variable selection and measurement technique, and interpretation of results are so seriously flawed as to render all empirical findings presented, and the economic implications stemming from them, unreliable, meaningless, and without substantive merit.

The statistical results upon which most of Cooper's conclusions are based are found in Table 10 (p. 37) of his study. All statements regarding the alleged overall costs to consumers of exclusive franchises are based on regression results derived by employing data from 1984 only. However, none of the regressions employing 1984 data provide evidence that the absence of state exclusivity arrangements produces lower malt beverage prices. Even though the estimated coefficients of the exclusivity variables appear to show price raising effects of exclusivity arrangements, none can be said to be significantly different from zero with any generally accepted degree of statistical confidence. These negative coefficients, which in Cooper's specification appear to suggest lower prices in non-exclusive states, are most likely the result of spurious statistical correlation or of not accounting for other relevant factors which affect price. Contrary to Cooper's conclusion, the absence of statistical significance of the estimated coefficients demands the interpretation that exclusivity arrangements have no effect on prices.

The Cooper study, as Tables 5, 6, 7, and 8 in this study clearly show, also suffers from severe model misspecification. A number of relevant variables that significantly explain retail beer prices were excluded from Cooper's regression equations. Not the least significant of which were state beer consumption, state-imposed advertising restrictions, the price of wine, and the average wage rate in each state. The omission of quantity consumed from a regression model purporting to explain price is such a serious violation of basic principles of economics that it renders his results devoid of content. Furthermore, Cooper argues for the exclusion of the advertising restriction variables from his estimating equations on the grounds that their impact is neutral on beer prices across states. Tables 3 and 4 of our study show this to be clearly not the case. In fact, it is quite possible that Cooper's empirical result which purports to show that exclusivity arrangements raise retail beer prices (even though his estimates are statistically insignificant) does not measure the effect of exclusivity at all due to the substantial number of excluded variables.

The Cooper study also attempts to draw a parallel between the beer industry and the soft drink industry by examining some soft drink industry data since passage of the Soft Drink Interbrand Competition Act of 1980 (SDICA). SDICA provided soft drink manufacturers the ability to assign exclusive territories in much the same fashion through which brewers assign exclusive territories in states which permit such assignments. Cooper notes that the return to equity ratio for soft drink manufacturers was greater than the all-industry average in the U.S. over the 1980-1985 period and infers that these higher than average rates of return were due, in part, to exclusive territory assignment allowed under SDICA. He then suggests that the legislation, and the exclusive territories, have somehow hurt soft drink consumers.

Cooper's data and analysis, however, do not provide any evidence whatsoever that passage of SDICA caused increased rates of return to equity in the soft drink industry. Nor does economic analysis suggest that high rates of return are at all necessarily indicative of market power (monopolistic practices), much less artificially high prices which reduce consumer welfare. In short, his data and analysis purporting to show SDICA as a source of monopoly power do not indicate any such thing.

Cooper's soft drink and all industry return to equity data are all post-1979. In order to argue that SDICA caused an increase in the soft drink industry return to equity a comparison of returns in the pre- and post-1980 period is necessary at minimum. One would also have to account for, in a formal statistical manner which Cooper has not developed, a number of other economic factors which contribute to profitability. Merely noting that the soft drink industry return to equity is higher than average says nothing about the impact, if any, of SDICA on rates of return in the industry.

Additionally, even if SDICA did increase the return to equity in this industry, one would be on extremely weak footing in suggesting that the increased returns to the industry necessarily came at the expense of consumer welfare.

Quite the contrary, higher than average rates of return on equity can in fact be a signal of both vibrant interindustry competition and improved efficiency within an industry. It is no secret that the early 1980s saw a shift in consumers' tastes away from alcoholic beverages in general toward soft drinks. With soft drink manufacturers responding to this change with a greater number of products as well as increased output of existing products, economic theory would predict a higher than average return to equity in the industry. In competitive markets, increases in demand can be expected to lead to higher returns for a period of time. Improved efficiency of firms in the industry would also lead to returns to equity higher than average. Merely noting that soft drink equity returns were higher than the U.S. industry average over some period without comparing other periods and without a theory or a formal statistical analysis isolating causes cannot be considered evidence of any kind that the SDICA was the cause of the above average returns.

Furthermore, even if SDICA did result in higher returns to equity in the industry (an hypothesis for which there is no support), Cooper's suggestion that these increased returns come at the expense of consumers and that consumer welfare is reduced is unfounded in both data and the theory. For the Act to have reduced consumer welfare, it must have resulted in higher prices and/or reduced output given other factors. Cooper offers no statistical evidence at all concerning the causes of overall soft drink price trends in the 1980s but does state that soft drink prices rose by approximately 21 percent. His suggestion that this constitutes a significant price increase is without merit in light of the fact that prices in general (inflation) rose by about 31 percent during the same period. This implies that soft drink prices adjusted for general price inflation actually declined by 10 percent over the period.

In summary, returns to equity in an industry relative to the average return over all industries can offer no insight or evidence with respect to market power or anti-competitive behavior on the part of firms in the industry. Cooper's argument that they can and do is empty. Additionally, his eroneous logic flies in the face of the fact that since passage of SDICA in 1980, real soft drink price declined by 10 percent through 1985. His suggestion that exclusive distribution territories created monopoly power in the soft drink industry and are likely to do so in the beer industry is without foundation from both statistical and theoretical perspectives.

APPENDIX II. DATA EMPLOYED IN CROSS-STATE ECONOMETRIC STUDY

SOURCES

Beverage World, May, 1985.

Bureau of the Census, U.S. Department of Commerce, *Statistical Abstract of the United States: 1986*, (Washington, D.C.: U.S. Government Printing Office, 1985).

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Bureau of the Census, U.S. Department of Commerce, *Survey of Current Business*, August, 1986.

Council of Economic Advisers, *Economic Report of the President*, (Washington, D.C.: U.S. Government Printing Office, 1987).

United States Brewers Association, *Special Information Book*, (Washington, D.C.: U.S. Brewers Association, 1985).

VARIABLE CODES

EI = Exclusivity dummy variable; 1 if state law mandates exclusivity of territories, 0 otherwise.

RN = Newspaper and magazine advertising restriction dummy variable; 1 if state law restricts newspaper and magazine advertising, 0 if such advertising is permitted without restriction or if no provisions exist.

RT = Radio and television advertising restriction dummy variable; 1 if state law restricts radio and television advertising, 0 if such advertising is permitted without restriction or if no provisions exist.

RXS = Exterior sign advertising restriction dummy variable; 1 if state law restricts exterior sign advertising, 0 if such advertising is permitted without restriction or if no provisions exist.

RWS = Window sign advertising restriction dummy variable; 1 if state law restricts window sign advertising, 0 if such advertising is permitted without restriction or if no provisions exist.

PCY = Nominal per capita income in thousands of dollars, 1984.

POP = Population in thousands, 1984.

CPI = Regional Consumer Price Index-All Items, 1984, based in 1977.

BC = Total beer consumption in thousands of gallons in 1984.

TFS = Total retail food (grocery and other food stores) establishments in 1982 (latest year data available).

EDS = Total eating and drinking establishments in 1982.

PBR = Nominal retail price of beer per gallon in 1984.

PWR = Nominal retail price of wine per gallon in 1984.

PSR = Nominal retail price of distilled spirits per gallon in 1984.

PSDR = Nominal retail price of soft drinks per gallon in 1984.

MWG = Nominal hourly manufacturing wage in 1984

STATE	EX	RN	RT	RXS	RWS	PCY	POP	CPI	BC
ALABAMA	1	1	1	1	1	8706	3989	1.680	71875
ALASKA	0	0	0	0	0	15320	505	1.674	14187
ARIZONA	0	0	0	1	0	10523	3072	1.674	91109
ARKANSAS	1	0	0	0	0	8622	2346	1.680	42064
CALIFORNIA	0	0	0	0	0	13032	25795	1.674	639580
COLORADO	0	1	1	0	0	12204	3190	1.674	81620
CONNECTICUT	0	1	0	1	1	14437	3155	1.640	63962
DELEWARE	0	1	1	0	0	11188	614	1.680	16298
FLORIDA	0	0	0	1	1	11264	11050	1.680	318761
GEORGIA	1	1	1	1	1	9932	5842	1.680	124214
HAWAII	0	0	0	1	1	11508	1037	1.674	29803
IDAHO	0	0	0	1	1	9323	999	1.674	23202
ILLINOIS	1	1	0	0	0	12053	11522	1.685	283548
INDIANA	0	1	0	1	1	10279	5492	1.685	121164
IOWA	0	0	0	1	0	10483	2903	1.685	69438
KANSAS	1	1	1	1	1	11164	2440	1.685	50587
KENTUCKY	1	1	1	0	0	9026	3720	1.680	68895
LOUISIANNA	0	0	0	0	0	9642	4461	1.680	106300
MAINE	1	0	0	1	1	9820	1156	1.640	25602
MARYLAND	1	1	1	0	0	12456	4349	1.680	104622
MASSACHUSETTS	0	0	0	0	0	12828	5798	1.640	141351
MICHIGAN	1	1	1	1	1	11112	9058	1.685	210473
MINNESOTA	1	1	1	0	0	11297	4163	1.685	98007
MISSISSIPPI	0	1	1	1	1	7644	2598	1.680	52251
MISSOURI	1	1	1	0	1	10741	5001	1.685	118935
MONTANA	1	1	1	1	0	9378	823	1.674	24222
NEBRASKA	1	0	0	0	0	10839	1605	1.685	40777
NEVADA	0	0	0	0	0	11676	917	1.674	31958
NEW HAMPSHIRE	1	1	1	1	1	12319	978	1.640	34822
NEW JERSEY	0	1	0	1	0	13730	7517	1.640	161942
NEW MEXICO	0	0	0	0	0	8881	1426	1.674	40286
NEW YORK	0	1	0	1	0	12542	17746	1.640	368111
NORTH CAROLINA	1	1	1	1	1	9520	6166	1.680	121873
NORTH DAKOTA	1	0	0	0	0	10426	687	1.685	16463
OHIO	1	1	1	1	1	10790	10740	1.685	267528
OKLAHOMA	0	1	1	1	1	10058	3310	1.680	58657
OREGON	1	1	1	1	1	10378	2676	1.674	60361
PENNSYLVANIA	1	1	1	1	1	10966	11887	1.640	296774
RHODE ISLAND	0	1	1	1	1	11592	962	1.640	24155
SOUTH CAROLINA	1	0	0	0	0	8766	3302	1.680	72591
SOUTH DAKOTA	0	0	0	0	0	9700	705	1.685	15343
TENNESSEE	1	0	0	0	0	9321	3720	1.680	92719
TEXAS	1	1	1	1	1	11052	16083	1.680	476023
UTAH	1	1	0	1	1	8669	1623	1.674	22149
VERMONT	1	1	1	1	1	9747	530	1.640	13943
VIRGINIA	1	1	1	1	1	11587	5636	1.680	126379
WASHINGTON	0	1	0	0	0	11784	4349	1.674	94794
WEST VIRGINIA	1	0	0	1	1	8465	1951	1.680	38367
WISCONSIN	0	0	0	0	0	10804	4762	1.685	156991
WYOMING	1	0	0	0	0	10554	513	1.674	13443

STATE	TFS	EDS	PBR	PWR	PSR	PSDR	MWG
ALABAMA	2997	3439	5.7510	14.6983	49.9948	2.6082	7.97
ALASKA	297	749	5.9848	15.0351	54.7963	2.3579	12.25
ARIZONA	1959	4191	5.3865	14.8975	52.0025	2.7815	9.09
ARKANSAS	1960	2512	5.3200	15.1370	49.9928	2.6040	7.31
CALIFORNIA	16749	36734	5.0250	14.6478	52.9996	3.4374	9.77
COLORADO	1869	5057	5.3865	14.8130	54.7970	2.9946	9.24
CONNECTICUT	2259	4612	5.8725	14.4920	52.9973	2.6875	9.22
DELEWARE	508	788	5.3867	14.3870	52.9871	2.7408	9.30
FLORIDA	9420	13933	5.0008	14.7731	47.9996	2.8508	7.62
GEORGIA	4720	6118	5.3600	14.8724	53.0019	3.0176	7.58
HAWAII	797	1741	6.0751	15.1013	54.8083	2.9203	8.35
IDAHO	753	1536	5.3200	14.7379	50.0150	2.7368	9.34
ILLINOIS	6334	16215	6.1215	15.3328	54.8000	4.0245	10.08
INDIANA	3116	7720	6.3495	14.0308	52.9973	2.9028	10.45
IOWA	2164	5298	5.8108	14.9072	49.9958	2.3387	10.25
KANSAS	1767	3613	5.3600	14.6876	52.9952	2.5830	9.40
KENTUCKY	2987	3817	5.3200	14.5682	49.9980	2.6767	9.28
LOUISIANNA	3755	4755	5.4270	15.3805	52.9994	2.6288	10.06
MAINE	1327	1629	6.2401	14.6377	50.0087	2.2649	8.05
MARYLAND	2970	5181	5.3460	14.3531	54.8010	2.8750	9.45
MASSACHUSETTS	4308	8755	6.0750	14.5957	50.0007	3.2082	8.50
MICHIGAN	6469	12260	6.2486	14.3193	44.9998	2.6192	12.18
MINNESOTA	2911	5687	6.3080	15.2606	52.9971	1.9509	9.75
MISSISSIPPI	2489	2218	5.4000	14.7611	48.0013	2.7456	6.95
MISSOURI	3334	6827	5.3200	13.9031	53.0008	2.2664	9.32
MONTANA	709	1925	5.9401	14.6388	52.0102	2.6352	10.74
NEBRASKA	1229	2870	5.4270	14.6231	50.0020	2.6855	8.93
NEVADA	623	1495	5.4675	14.5262	54.7989	3.0567	9.12
NEW HAMPSHIRE	924	1378	6.5156	14.4989	51.9943	2.5625	7.85
NEW JERSEY	5821	10482	6.1690	14.0410	50.0009	3.1461	9.50
NEW MEXICO	1001	1929	5.3200	14.2491	51.9845	2.7624	7.97
NEW YORK	14850	26168	6.2000	14.6598	54.7997	3.3274	9.22
NORTH CAROLINA	5372	6670	5.4000	15.1294	50.0010	3.1255	7.01
NORTH DAKOTA	533	1261	5.3459	14.3665	50.9857	2.4788	7.86
OHIO	7716	15787	6.0800	13.8308	49.9993	2.9760	10.96
OKLAHOMA	2674	4256	5.3600	4.7588	49.9990	2.7497	9.64
OREGON	2370	4581	5.2934	13.4282	49.9966	2.8305	10.44
PENNSYLVANIA	8594	16228	5.9675	14.0207	52.0003	3.4202	9.28
RHODE ISLAND	780	1571	5.7999	14.4348	51.9952	2.5895	7.23
SOUTH CAROLINA	2616	3372	5.4675	14.3804	49.9977	3.0888	7.28
SOUTH DAKOTA	583	1286	5.4270	14.0465	50.9919	2.5601	7.15
TENNESSEE	3857	4913	4.9665	12.8681	48.0014	2.3353	7.93
TEXAS	13103	19755	4.9875	14.8621	54.7991	2.8305	9.04
UTAH	867	1693	6.0301	19.2649	50.0105	2.9601	8.95
VERMONT	662	908	6.1688	14.5210	53.0167	2.8033	8.03
VIRGINIA	4465	6024	5.3332	14.9709	52.9995	2.9082	8.12
WASHINGTON	3299	6343	5.0820	14.0351	52.0006	2.8116	NA
WEST VIRGINIA	1553	1955	5.1205	14.3396	51.0026	2.8160	9.93
WISCONSIN	3107	9493	6.0800	14.2163	49.9981	1.2720	10.03
WYOMING	315	897	5.3466	14.5300	52.0195	2.9276	8.86

APPENDIX III. THE MICHIGAN AND ALABAMA STUDIES

Draft #3 6/11/85
(Beertext/202)

AN ANALYSIS OF MICHIGAN BEER PRICES AND BEER REVENUES, 1967-1983

Prepared by the

MICHIGAN DEPARTMENT OF PUBLIC HEALTH
OFFICE OF SUBSTANCE ABUSE SERVICES

Beer Prices, State Revenues, and Inflation

Figure 1 shows price, revenue, and inflation trends in Michigan from 1967 through 1983.(5) The 1967 starting point is taken because this is the year set by the federal government as the most recent base year for calculating the consumer price index (CPI). From 1967 to 1983, the overall price of consumer goods in Michigan increased nearly 300%. Disposable income rose from $2,913 to $9,725, a 230% increase. However, retail beer prices increased by only 220%, meaning that beer prices have declined relative to other products and to the amount of money people have to spend. Over time, beer prices have become comparable to or lower than prices for soft drinks and fruit juices. It must be questioned whether this is a healthy situation for the population as a whole.

State beer tax revenues increased 18.84% from 1967 to 1983. Because 1983 dollars are worth considerably less than 1967 dollars, this represents a decline in revenue over time. Michigan's beer excise tax revenues have steeply declined in value between 1967 and 1983. The 1983 revenues of $43,666,960 are worth only $14,727,474 in 1967 dollars. To have kept even with inflation, 1983 revenues should have been $109,275,552. This means that there was an income "loss" of $65,608,592 *in 1983 alone.*

Figure 1

MICHIGAN BEER PRICES, REVENUES, AND INFLATION, 1967-1983

	1	2	3	4	5	6	7	8
YEAR	BARRELS SOLD	BEER EXCISE TAX REVENUE	Tax Revenue In 1967 dollars	MICHIGAN CPI	PER CAPITA DISPOSABLE INCOME	MICHIGAN BEER CPI	SIX-PACK RETAIL PRICE TAKE-OUT	SIX-PACK PRICE IN 1967 DOLLARS
1967	5,832,648	$36,855,161	$36,855,161	100.0	$2913	100.0	$1.23	$1.23
1968	5,855,414	$36,741,982	$35,227,212	104.3	$3133	102.8	$1.26	$1.21
1969	5,829,861	$37,315,892	$33,739,505	110.6	$3311	105.4	$1.30	$1.18
1970	6,302,456	$38,466,376	$32,765,227	117.4	$3423	108.9	$1.34	$1.14
1971	6,310,608	$39,547,160	$32,495,612	121.7	$3719	112.9	$1.39	$1.14
1972	6,507,834	$40,784,125	$32,317,056	126.2	$4017	113.9	$1.40	$1.11
1973	6,443,063	$40,702,070	$30,261,762	134.5	$4506	115.6	$1.42	$1.06
1974	6,805,882	$42,207,094	$28,307,910	149.1	$4823	126.8	$1.56	$1.05
1975	7,019,820	$44,473,106	$27,743,672	160.3	$5153	140.3	$1.73	$1.08
1976	6,971,085	$43,685,361	$25,864,631	168.9	$5699	143.1	$1.76	$1.04
1977	7,431,961	$46,198,769	$25,609,074	180.4	$6340	147.2	$1.81	$1.00
1978	7,301,175	$45,875,704	$23,635,087	194.1	$7060	160.0	$1.97	$1.01
1979	7,012,142	$43,962,254	$20,092,438	218.8	$7750	191.5	$2.36	$1.08
1980	7,005,853	$43,887,440	$17,312,600	253.5	$8348	210.5	$2.59	$1.02
1981	6,968,258	$44,012,367	$15,883,207	277.1	$9208	222.2	$2.73	$.99
1982	6,849,518	$44,709,253	$15,507,892	288.3	$9214	215.3	$2.65	$.92
1983	6,946,711	$43,666,960	$14,727,474	296.5	$9725	220.0	$2.71	$.91

During this same time period, it is clear that increases in beer retail prices lagged behind overall inflation increases. While the price of a six-pack rose 220% over the 16 years, prices in general rose by 296.5%. Retail beer prices, then, dropped in effect over time. In 1967 dollars, a six-pack that cost $1.23 in 1967 cost only 91 cents in 1983. Put another way, the price of a six-pack would have risen to $3.65 by 1983 ($1.23 x 2.965), nearly one dollar over the $2.71 price shown in figure 1. That beer prices have not been subject to general inflationary increases may be an enviable business achievement by beer manufacturers. But this achievement has been costly to the citizens of Michigan, in terms of lost State revenues and in terms of greater risks to public health and public safety.

Spirits taxes include the State mark-up of 51% on the State's purchase price (Sec. 436.16(1)), which was last revised in 1980 with an increase from 48%. Three specific taxes are applied to the purchase price plus mark-up. One is a 4% tax imposed in 1957, with revenues deposited in the School Aid Fund (Sec. 436.101). A second 4% tax took effect in 1960, applied to the General Fund (Sec. 436.121). A 1% tax applying only to off-premise sales was added in 1973, and increased to 1.85% in 1978, with proceeds deposited in the Liquor Purchase Revolving Fund (Sec.436.131).

Retail licensees receive a 17% discount on their purchases from the State (Sec. 436.16(3)). For off-premises licensees, this discount constitutes the gross profit margin, since take-out prices are set by the State (the MLCC) and may not be raised or lowered. On-premises licensees receive the same discount, but may charge whatever they wish for drinks, so long as the price is not less than what they paid for the alcohol.

5. Data on barrels sold and beer excise tax revenues are from the Liquor Control Commission's 1983 "Statistical look." Michigan CPI and disposable income data are from the Michigan Department of Management and Budget. Data in column 3 (1967 dollars) were computed by dividing each year's revenues by that year's CPI. Beer CPI data are from R. Sjolander and P. Kakela, "Effects of Michigan's Mandatory Beverage Container Deposit Law," Department of Resource Development, Michigan State University, East Lansing, Michigan. Annual six-pack prices are estimated based on the beer CPI, and do not include sales tax and bottle deposit. The price estimates assume that a six-pack of premium domestic beer (e.g., Stroh's, Budweiser) cost $2.71 in 1983. Prices for other years were then computed from the beer CPI.

It should be noted that figures in columns 1 and 2 are inconsistent for some years, in that barrels sold multiplied by the $6.30 tax does not equal the tax revenue figure. For example,the 1983 sales of 6,964,711 barrels would equal $43,764,279 when multiplied by $6.30, not the $43,666,960 shown. Nevertheless, these are the figures published by the MLCC. Discrepancies may be due to calculations being made on a calendar year vs. fiscal year basis, to rebates for lost or broken products, or to accounting variations.

THE ECONOMIC IMPACT OF THE BEER AND WINE INDUSTRIES ON THE ALABAMA ECONOMY

A STUDY BY:

Philip Gregorowicz, Ph.D.
Charles E. Hegji, Ph.D.
A. Wayne Lacy, Ph.D.

January, 1987

This study constitutes the research efforts and judgement solely of the authors, and should not be taken to represent the views of AUBURN UNIVERSITY at MONTGOMERY.

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APPENDIX C

THE IMPACT OF THE DISTRIBUTORS' TERRITORIAL BILL

In May, 1984 the Alabama legislature passed a territorial bill that limited the distributional areas serviced by beer and wine distributors. One of the concerns that emanated from this bill was that such action would limit competition and raise prices to Alabamians, despite the presence of competition between brands. To test this contention, the data on prices of beer and wine were examined for the quarter in which the bill was passed (1984, Q2) and compared to data for the latest quarter available (1986, Q3), which was 21 months later.

The results are shown in Tables C-1 and C-2. Prices are shown for six Alabama cities and the mean price for Alabama is compared with the mean price for over 200 U.S. cities. The figures would tend to support the view that the primary competition in the beer and wine industry is between distributors of different brands rather than between distributors of the same brands operating out of different territories. Since the territorial law was passed, the price of beer in Alabama rose in four cities, fell in three and fell overall in the state by 11¢ per six pack. This compares to an 11¢ increase in the U.S. overall. For wine, prices rose in four cities, fell in three and fell overall in the state by 17¢ per liter. At the same time, prices fell by only 3¢ nationally.

Although many factors enter into the pricing of beer and wine, no evidence can be found in these data that the territorial bill has been harmful to the Alabama consumer.

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TABLE C-1

Beer Prices Per Six Pack

CITY AREA	1984 Q2	1986 Q1	CHANGE
Anniston	3.72	3.47	-.25
Birmingham	3.11	3.37	+.27
Dothan	3.25	3.30	+.03
Gadsden	3.36	2.90	-.46
Huntsville	3.56	3.29	-.27
Mobile	3.28	3.31	+.03
Montgomery	3.18	3.26	+.08
Tuscaloosa	N/A	3.03	N/A
Alabama (Mean)	3.35	3.24	-.11
U.S. (Mean)	2.91	3.02	+.11

TABLE C-2

Wine Prices per 750 ML.

CITY/AREA	1984 Q2	1986 Q1	CHANGE
Anniston	4.40		-.62
Birmingham	5.54	5.09	-.45
Dothan	5.48	5.50	+.02
Gadsden	6.04	5.09	-.93
Huntsville	4.96	5.41	+.45
Mobile	5.80	5.84	+.04
Montgomery	5.41	5.76	+.35
Tuscaloosa	N/A	5.19	N/A
Alabama (Mean)	5.38	5.21	-.17
U.S. (Mean)	4.77	4.74	-.03

SOURCE: American Chamber of Commerce Researchers Association
Inter-City Cost of Living Index

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Senator DeConcini. Thank you, Professor Tollison.

We will now hear from Richard Willett.

Mr. Willett. Senator, I am Richard Willett. I am a partner in Grant Thornton. We are an international accounting and management consulting firm. I am appearing before this committee today to report on the results of an independent analysis that we at Grant Thornton did regarding selected aspects of the Malt Beverage Interbrand Competition Act, and I must point out that our work was sponsored by the National Beer Wholesalers Association.

We have talked a lot today about the so-called 20-percent reduction in prices in Indiana, and I will not spend any more time on it except to suggest that 4 years ago when we appeared before this subcommittee that 20 percent notion seemed to be the key item on which the opposition was basing its case.

Now, we have moved to something new, and that is the claim by Attorney General Abrams that retail beer prices have gone up extensively in New York over the last few years, 35.7 percent through 1985, and now we have seen that the number has gone up to 39 percent.

We would like to spend the few minutes that we have got today, and we talk about this more extensively in our testimony, talking about what has happened to retail prices in New York and in two other States since they have adopted exclusive territories.

We have got a couple of exhibits up here. The one on my left talks about wholesale prices in New York since 1982. Since 1982 into 1985—and these were the years that Attorney General Abrams used in his initial study—we see that wholesale prices in New York did go up, but not a lot. They went from $7.81 a case to $8.69 a case, an increase of 88 cents, or 11.3 percent over those 3 years.

Now, let us look at retail prices. Up here on Exhibit II, we show what happened in a similar time frame to retail prices in New York. There, the increase was from $10.90 a case over the same period to $13.35 a case, an increase of 22.5 percent, or roughly double the increase in wholesale prices.

Now, we have looked at the impact of the Bottle Act and we have adjusted our prices so that the Bottle Act does not impact either the wholesale or the retail prices. So we are talking about apples in both cases rather than apples and oranges.

Let us put up the other chart, if we might, please. We have got another exhibit now. Exhibit III in New York shows a couple of things that have happened to beer prices. In 1982, as we mentioned before, wholesale prices were $7.81 a case. In 1985, it changed, as we mentioned, to $8.69, an increase of 11.3 percent.

Now, we see over here on the right-hand side some external cost factors and revenue factors that were impacting on wholesalers, and we see generally that the increase in cost to wholesalers—that is, coming from brewers and taxes, et al.—was somewhere in the range of about 77 cents to a little less than a dollar.

Then we go to retail. As we mentioned before, there was a 22.5 percent increase in retail prices over this same period. Some of it was made up in wholesale prices, but overall there was a net cost increase to retailers of about 58 cents. Yet, their prices went up about $2.50. So we do not see any basis in New York for the retail price increase, at least based on what came through to them from the wholesalers.

Now, let us put up the two other exhibits, if we might, and I will very quickly talk about what has happened in two States that we have looked at, also, as part of our study; that is, Alabama and Missouri.

Looking first at Alabama, which established an exclusive territory act in May of 1984, we see that beer prices there at the wholesale level have gone from $11.62 up to $12.28 in 1985, and then back in 1986 to $12.20. So there has been a very small percentage increase and, in fact, a reduction in the last year.

Essentially, the same thing has happened in Missouri, which adopted exclusive territories in September of 1985; no major increases in wholesale prices in either one of these two States.

Now, let us put up the charts and talk about what happened to wholesale prices versus the Consumer Price Index in those two States, and we will see that generally beer prices have gone along with the CPI or been a little less over the course of these three years.

So let me summarize by just saying a couple of things. Opponents of this legislation have continually brought up the charge that it is anti-consumer because it will increase prices.

As I mentioned, 4 years ago it was the Indiana 20 percent. We believe that we have disproved that point. Yet, it still comes up occasionally. Now, we have the numbers from New York, 35.7 percent, now increased to 39 percent, suggesting that the reason that prices in New York have gone up is because wholesale prices have gone up.

Our testimony today shows that there is a price increase at the wholesale level of only 11.3 percent, while retail prices have gone up 20 percent. Also, we looked at two other States and found essentially the same thing.

Thank you, Senator.

[Prepared statement follows:]

Before the Senate Judiciary Subcommittee
on
Antitrust and Monopolies
Regarding
The Malt Beverage Interbrand Competition Act (S567)
Richard B. Willett, Partner
Grant Thornton
August 4, 1987

Good afternoon, Mr. Chairman and members of the Subcommittee. I am Richard B. Willett, a partner of Grant Thornton, an international accounting and management consulting firm. My principal areas of practice are financial and economic analysis, financial systems design and management controls. I am appearing before you today to report the results of our independent analysis regarding certain aspects of the Malt Beverage Interbrand Competition Act. Our work was sponsored by the National Beer Wholesalers Association.

Background

During testimony on predecessor legislation in the past several years, it has been alleged by some of those opposed to the legislation that the retail price of beer would increase if this legislation were enacted into law. In 1982 and 1983 the opponents based their argument on a purported study in Indiana which showed a 20 percent drop in retail beer prices following passage in March, 1979 of Rule 28 outlawing exclusive wholesale territories.

Our analysis at that time showed that the passage of Rule 28 had no effect on prices, and that, in fact, there was no analytical study to provide a basis for the 20 percent figure. Despite my testimony and the corroborating testimony of the Attorney General Pierce of Indiana, the 20 percent figure keeps coming up. The fact is that there never was a study and the 20 percent figure was probably derived from a misunderstanding regarding savings which could be achieved if the retailer picked up the product from the wholesaler. I should also point out that this practice is illegal today.

Now the opponents of the legislation are rallying around testimony in the past several years by the Attorney General for the State of New York claiming that there was a 35.7 percent increase in retail beer prices in New York City after the brewers adopted exclusive territory restrictions on their wholesalers in 1983. (See letter to Honorable Strom Thurmond, Chairman, Committee on the Judiciary from Lloyd Constantine, Assistant Attorney General in Charge Antitrust Bureau, Department of Law, State of New York, dated May 30, 1985).

Our work for NBWA which we are reporting on today focuses on the New York City price situation as well as the price situation in several other states that have recently enacted exclusive territory legislation.

THE RETAIL PRICE SITUATION IN NEW YORK CITY

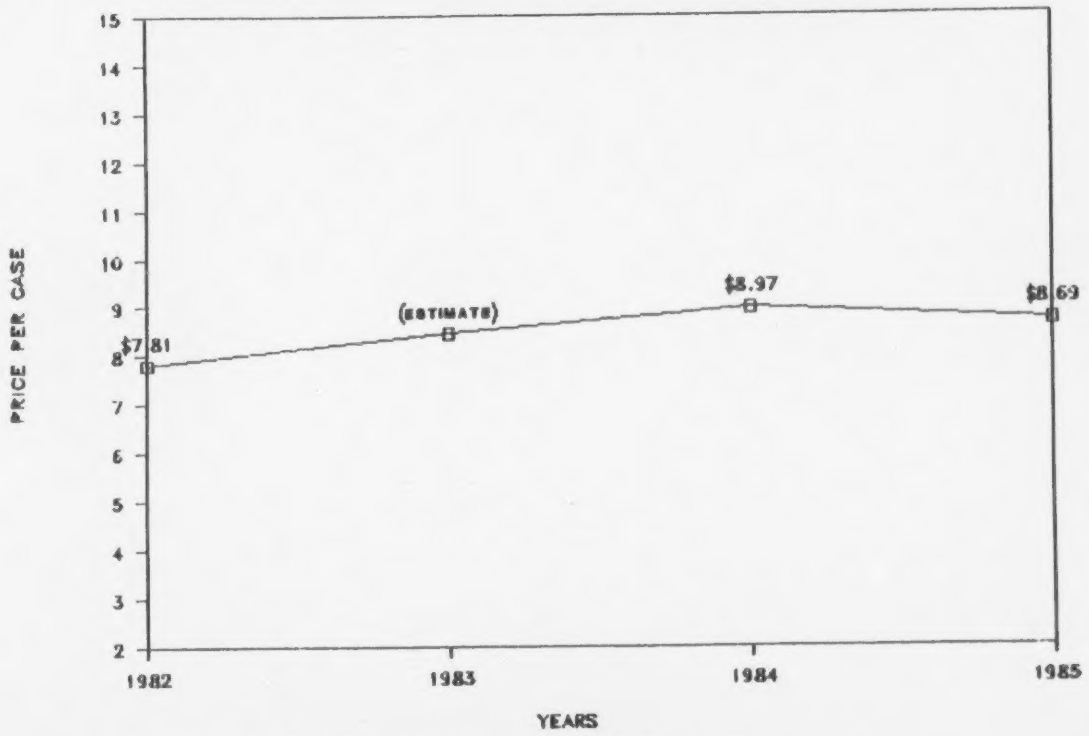
In September, 1983 the State of New York implemented a returnable container law which drastically changed the price structure for beer. Unlike most deposit laws in which the retailer adds the deposit to the retail price of beer and then rebates it to the consumer when the containers are returned, the New York system builds it into the basic price at both the wholesale and retail levels. The net effect, however, is the same.

In New York individual consumers can return a case of containers and receive a refund of $1.20. However, as estimated by the New York State Department of Environmental Conservation, only 82 percent of containers are returned. This means that on average 98 cents per case sold is actually included in the price system and returned to the consumer. Accordingly for the purposes of this analysis the 98 cents has been deducted from wholesale and retail prices since it, in essence, artificially inflates both prices.

We performed a survey of wholesale beer prices in New York City for the 1982-1985 time period which coincided with the period covered by the Attorney General's testimony. Exhibit I displays the resulting data. The annual average wholesale price in 1982 was $7.81 and it had grown to $8.69 in 1985, an increase of 88 cents or 11.3 percent.

EXHIBIT I

NEW YORK CITY WHOLESALE BEER PRICES



Prices exclude an average deposit per case of 98 cents

Our analysis indicates that there were five cost/revenue factors that impacted wholesalers during this period:

- Brewer price increases which ranged from 60 to 90 cents per case

- A tax increase of 2 3/8 cents per case

- A payment to retailers of 36 cents per case for each case of containers returned. Because of the 82% return rate this works out to 30 cents per case on the basis of the number of cases sold.

- Increased costs to the wholesalers for handling, storing and transporting returned containers

- Revenue of 15 - 25 cents per case for recycling returned containers

The effect is that wholesalers had net cost increases of 77 cents to 97 cents per case not counting the costs of handling, storing and transporting returned containers. Their prices increased by 88 cents.

Turning now to the retail side and using the data presented by the Attorney General, it is possible to describe certain price/cost factors that impacted them.

Before doing this we made three adjustments to the data:

- 6-pack prices were increased to reflect case prices by multiplying by four

- Average annual prices were computed using the data supplied by the Attorney General

- The average amount refunded (98 cents) was taken out of the price data

The results of these adjustments are shown in Exhibit II. Retail beer prices increased from $10.90 in 1982 to $13.35 in 1985, a $2.45 or 22.5 percent increase. During this period retailers were faced with a 88 cents increase from the wholesaler as described above. In addition, retailers were faced with two impacts of the returnable container law:

- They had increased costs for storing and handling returned containers

- As specified in the law they receive a payment of 36 cents from wholesalers for each case of containers returned to the wholesalers. Because of the 82% return rate this works out to 30 cents per case sold.

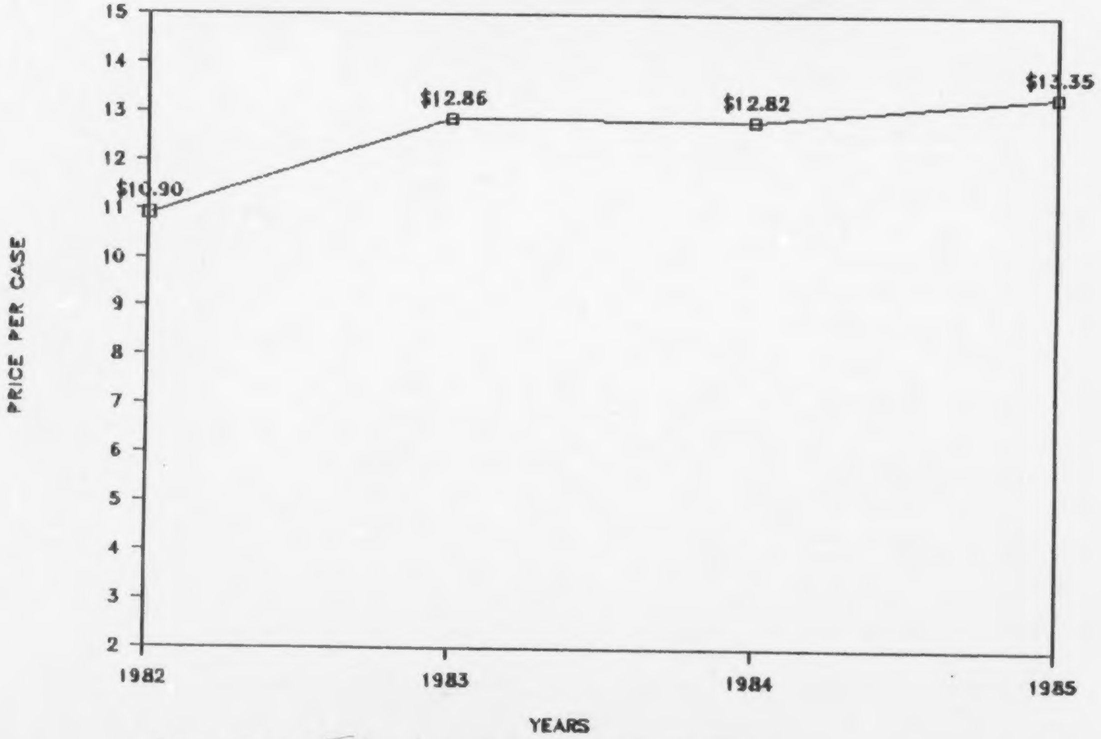
Exhibit III summarizes the situation in New York during this period:

- Wholesalers increased prices 88 cents per case with costs increasing from 77 cents to 97 cents
- Retailers increased prices $2.45 with increased costs of 58 cents

The New York Attorney General has attributed the increase in the retail price of beer to enforcement of exclusive territories by the brewers in the early 1980s. The testimony that has been submitted by Mr. Frank Parker states that no one in New York City operates on the basis of exclusive territories. And our study has shown that increases in wholesale beer prices are explained in terms of increased costs. The only conclusion that can be drawn from this is that even if exclusive territories were, in fact, enforced in New York, they have not been a factor in the recent wholesale price increases.

EXHIBIT II

NEW YORK CITY RETAIL BEER PRICES



Prices exclude an average deposit per case of 98 cents

EXHIBIT III

BEER PRICES IN NEW YORK 1982 - 1985

	1982 Price	1985 Price	Increase	Major External Cost/Revenue Factors	
WHOLESALE	$ 7.81	$ 8.69	$ .88 (11.3%)	o Brewer Prices	$.60 - .90
				o Taxes	.02
				o Payments to Retailers For Returns	.30
				o Cost of Handling, Storing & Transporting Returns	--
				TOTAL COSTS	$.92 - 1.22
				Less:	
				Recycling Revenue	.15 - .25
				NET COST INCREASE	$.77 - .97
RETAIL	$10.90	$13.35	$2.45 (22.5%)	o Increase in Wholesale Prices	$0.88
				o Costs of Storing & Handling Returns	--
				TOTAL COSTS	$0.88
				Less:	
				Payment for Handling Returns	0.30
				NET COST INCREASE	$0.58

Price of Beer in Alabama and Missouri

Exclusive territory legislation has been passed in recent years by the States of Alabama and Missouri. Alabama's was enacted in 1984 and Missouri's in 1985. In order to assess the impact of this legislation on the price of beer in each state we studied prices charged by wholesalers for the most popular brands of beer. Let me briefly summarize the results for both states.

Exhibit IV shows the results for Alabama. As can be seen in the exhibit, wholesale prices increased from $11.62 in 1983 to $12.28 in 1985 and then decreased to $12.20 in 1986. Exclusive territories were mandated in May of 1984. Clearly this had no discernible effect on wholesale prices.

The results of our work in Missouri are shown in Exhibit V. Here we found a total price increase of 7.8 percent over the period covered or approximately 2.6 percent per year. As shown in the exhibit, this increase has been relatively steady over the period covered. In Missouri exclusive territories were mandated in 1985. Again there has been no effect on the overall price trends.

Exhibits VI and VII show the percentage change in Alabama and Missouri wholesale prices and compare them to the Consumer Price Index for Beer and Ale. From these exhibits we see that:

- Alabama wholesale beer prices closely follow the Consumer Price Index for the first three years and in the last year outperform it as the price actually went down.

- Missouri wholesale beer prices closely follow the Index in all three years.

EXHIBIT IV

ALABAMA WHOLESALE PRICES

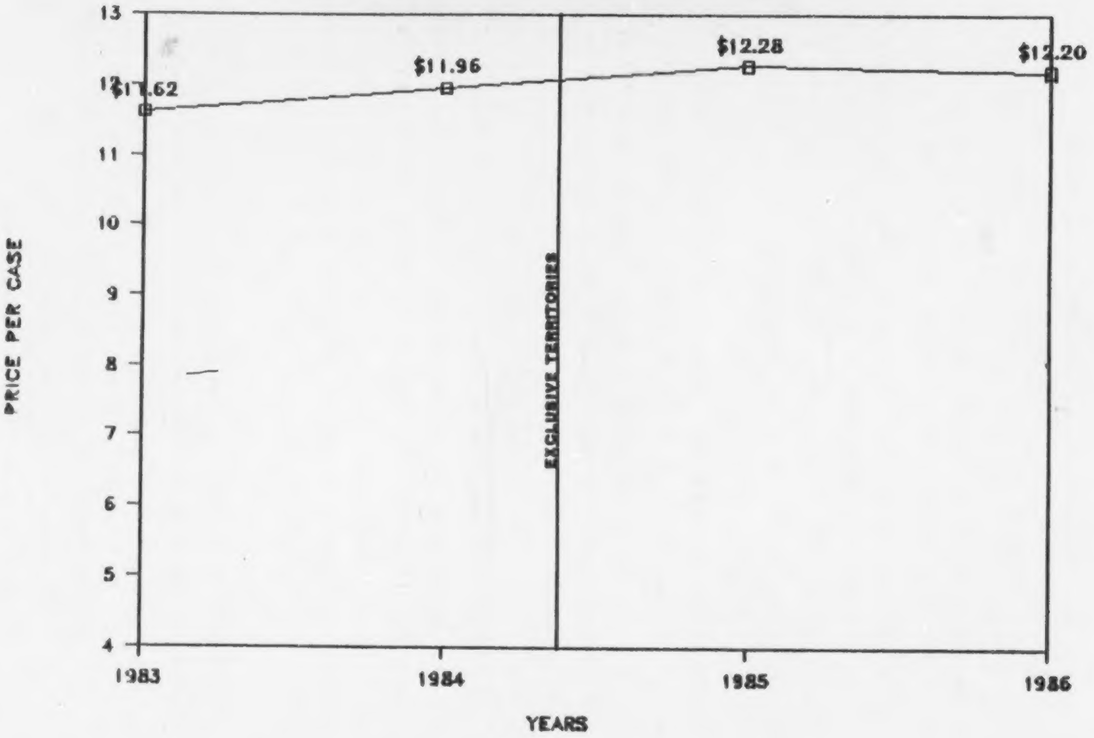


EXHIBIT V

MISSOURI WHOLESALE PRICES

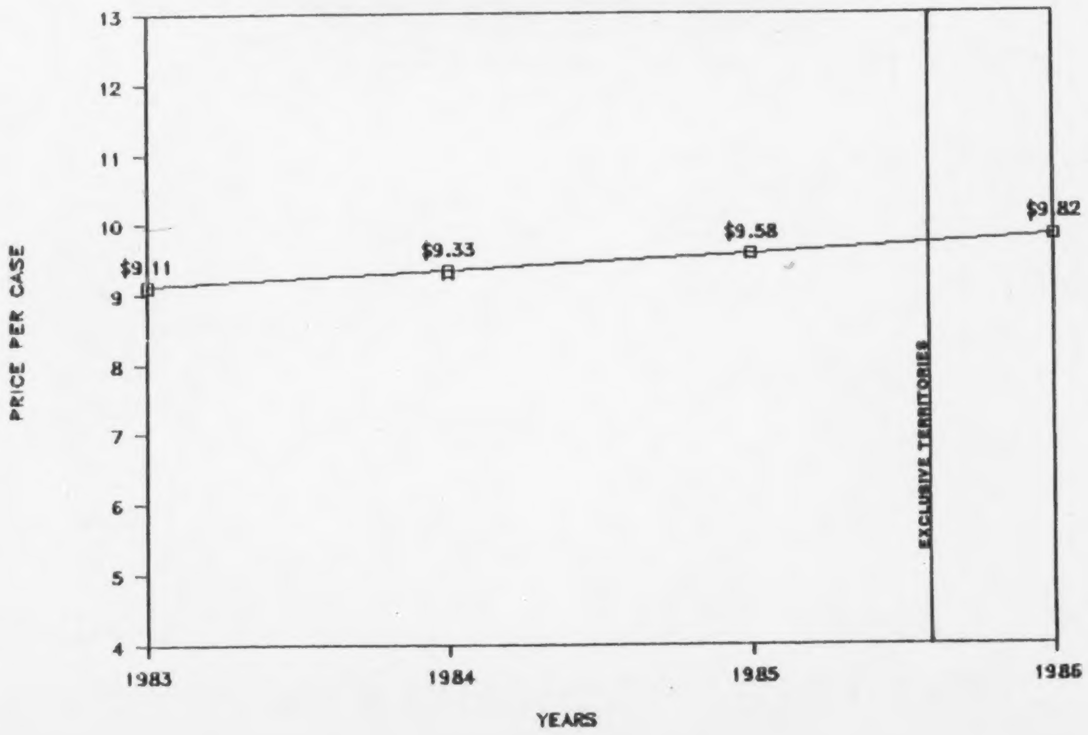


EXHIBIT VI

ALABAMA WHOLESALERS vs. CPI BEER & ALE

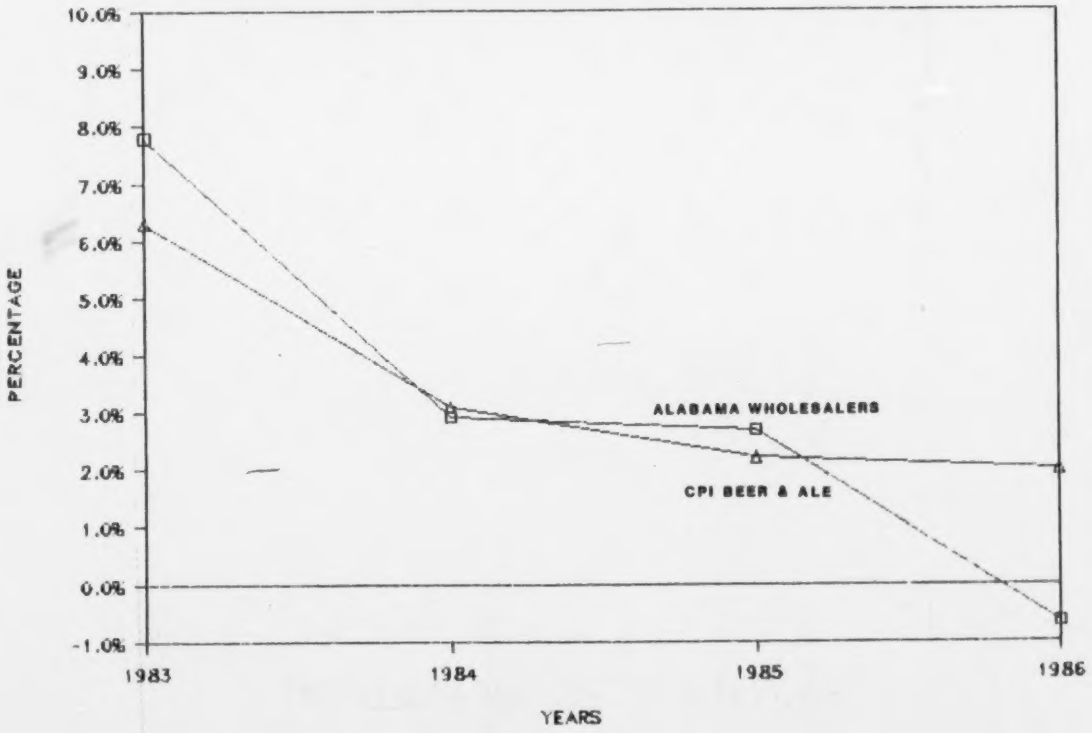
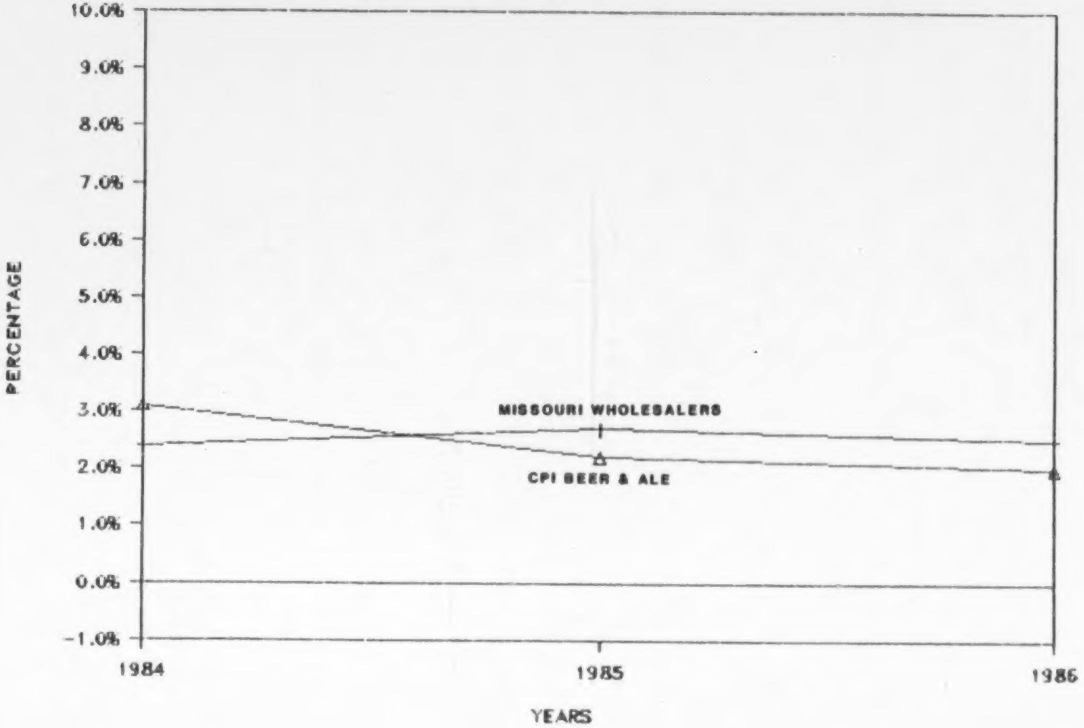


EXHIBIT VII

MISSOURI WHOLESALERS vs. CPI BEER & ALE



Conclusions

Opponents of this legislation continually bring up the charge that it is anti-consumer, because it will increase prices. In the early 1980s it was the Indiana "20 percent". Although we disproved this point previously it still comes up occasionally. Next we have the New York Attorney General testifying that the 35.7 percent increase in beer prices was attributable to enforcement of exclusive territories in that state. Our testimony today shows that there was a price increase at the wholesale level of 11.3 percent and that it is explained by brewer price increases and operation of New York's returnable container law.

Also, we have gone one step further and looked at wholesale beer prices in two states that recently enacted exclusive territory legislation. In both cases the enforcement of exclusive territory arrangements had no effect on the overall price trend.

In addition to our work there are recent third party studies dealing with Michigan and Alabama. Each clearly demonstrates that prices did not increase with the passage of exclusive territory legislation. In fact we know of no reputable study which contradicts our findings that exclusive territories do not of themselves increase prices.

* * * * * *

I thank you for your time and attention and I'm prepared to answer any questions you may have.

Senator **DeConcini**. Mr. Willett, thank you very much.

Mr. Carstensen, you state that S. 567 may result in higher beer prices. How do you respond to the Department of Justice finding that no study has conclusively shown that exclusive territories lead to higher beer prices?

Mr. **Carstensen**. I think that the emphasis is on the word "conclusively." The Justice Department quite obviously has not had a major grant to conduct an investigation in this area to collect the data that is important.

As I tried to indicate very quickly at the end of my statement, there are major flaws in these studies. As has been indicated at some length, there are also some substantial flaws in the other studies.

It would take a major investment of resources focusing on appropriate data, and we did describe what would be some of the appropriate statistical, empirical tests, none of which have been performed here, to begin to try to address that question. So I can understand exactly why the Justice Department would conclude that there is no conclusive evidence on that point.

Senator **DeConcini**. Well, would you not think the Department of Justice would be seeking out something here in the fact that they oppose this legislation, and yet they are candid enough to say there is nothing there?

Mr. **Carstensen**. No. What they have said is that they are not pursuing anything right now. They seem to be after the soft drink bottlers just at the moment. After all, the Attorney General of New York has undertaken the costly and difficult task of going after the brewers. So there is a little, shall we call it market allocation, between the State Attorney General of New York and the Justice Department in what they are investigating in these areas.

Senator **DeConcini**. We are told that the Justice Department has considered the New York study, has considered all the other studies.

Mr. **Carstensen**. Oh, on the studies, yes. The data that they——

Senator **DeConcini**. So it is not that they have not had a lot of information, and yet they draw that conclusion.

Mr. **Carstensen**. I am sorry; I misunderstood. I thought you were asking about whether they should be out there pursuing matters further. They have looked at this information and quite understandably, it seems to me, have concluded that this is not conclusive evidence that prices are increased.

I am saying that the testimony you have received today is hardly conclusive evidence that prices have decreased, and that, in fact, the problem is that the right questions are not being asked, the right data is not being looked at to get us to some more conclusive answers.

Senator **DeConcini**. Regarding the Alabama study there, what is wrong with that study as far as showing the CPI versus the wholesale prices? Is there something wrong with that?

Mr. **Carstensen**. What that tells me is what has happened to beer related to the CPI.

Senator **DeConcini**. What is the matter with that?

Mr. **Carstensen**. It does not tell me if, prior to 1983, there had been a major price-fixing conspiracy in beer such that that was breaking down in Alabama. I would predict that prices for beer would fall more dramatically than the cost of living index. You have got to know what you are comparing——

Senator DECONCINI. How far back would you go, 100 years or 2,000 years, or something?

Mr. CARSTENSEN. I think the most interesting table, actually, is this one in the Tollison article, which is the relative price of beer from 1957 to 1985. If you look at the period after *Schwinn* and before the *Sylvania* case, what you notice is the most rapid decline in price.

1983, remember, is when we get the reinstitution of formal—who knows what the informal situation was—territorial assignments in the beer industry. You will notice that the price of beer, deflated and adjusted, goes up, which is exactly what we would predict would happen.

Senator DECONCINI. How much does it go up, substantially or a small amount?

Mr. CARSTENSEN. It is a blip; it comes up a little bit. But think of it: For all the period when we have open competition in beer, at least as a matter of law, it tends downward. The minute we introduce territorial restraints on a rigid nationwide basis, the first opportunity, really, to make this thing happen, price goes up.

But, and this is terribly important, Senator, that may be okay. Remember what the man from Vermont was saying. He was getting service in return, he felt, for the higher price. What Rick Dahlson and I expected to find was a record of real documentation of the kind of service that would justify the upward-sloping prices that we see in Alabama.

Remember, 1983 is when exclusive territories begin in Alabama by contract; price goes up. We looked for evidence that there was an efficiency justification—the economic theories are quite clear on this; they are well worked out. You know what you are looking for. The outcome really, frankly, shocked me—we were surprised. We expected a far stronger record, Senator, that there were real service needs, real free-rider problems, and it just does not wash. There just do not seem to be——

Senator DECONCINI. Yet, Mr. Henry and even Mr. Lees from Massachusetts indicated periods of time before then when they could not get service if they did not have exclusive territory. So, obviously, service did play a role.

Mr. CARSTENSEN. There is some question on the service issue. Now, I did not understand Mr. Henry to say he had ever had a problem with service in the beer industry. I suggest in my written statement, and I suggest to you again this has got to be looked at—I attempted to say case-by-case, but that would be an inappropriate way to phrase it here. It has got to be looked at restraint by restraint, beer by beer. What are we getting for the restraint? That is the beauty of putting it under the antitrust law.

Senator DECONCINI. How do you respond to this chart here where the price of beer in comparison to other commodities has not been excessive?

Mr. CARSTENSEN. Where do we start in terms of years? I cannot see it.

Senator DECONCINI. From 1967.

Mr. CARSTENSEN. Okay. Again, notice that most of what you measure in that is the period of free and open competition.

Senator DECONCINI. Well, until the exclusive territory were applied.

Mr. CARSTENSEN. Until the exclusive jurisdiction stuff begins to come in rigorously in about 1983.

Senator DECONCINI. In 1983 is when they started.

Mr. CARSTENSEN. Yes, and notice that it begins to show some——

Senator DECONCINI. It seemed to level out, did it not?

Mr. CARSTENSEN. Well, it levels out there at 1985.

Senator DECONCINI. Yes, you are right.

Mr. CARSTENSEN. But, again, Senator, this is the point where we need better understanding of where we are starting from.

Senator DECONCINI. Would you agree that it goes up much more rapidly from 1976 to 1983 than it does from 1983, say, to 1985?

Mr. CARSTENSEN. Yes. In other words, from approximately after the decision in the *Sylvania* case when territorial restraints become more clearly acceptable, it tends to parallel the CPI more, and there are some other blips in there.

Senator, the first point again is that you have got to know where you are starting from because——

Senator DECONCINI. I know where I am starting from.

Mr. CARSTENSEN. Touche.

If we start from an industry with a relatively high price relative to costs and competition comes into that industry one way or another, we would expect price relative to other measures to decline.

So I need better data than I have seen anywhere about the states of competition at various points in time to be able to know what price comparisons alone mean. It is a red herring in this debate. The question is service against price and not price alone.

Senator DECONCINI. Mr. Willett, would you like a minute or two to justify your studies here in Missouri and Alabama? I was pretty impressed with them, but I think you are entitled to certainly respond to Mr. Carstensen.

Mr. WILLETT. Yes, thank you, Senator. The reason that we picked the period 1983 to 1986 is that is the same period that Attorney General Abrams used. So we felt that looking at the same period he used made total sense.

There are not any fancy economic theories behind any of the things we have done. We have simply looked at prices as they existed before and after.

Senator DECONCINI. You could have picked a longer period of time if you wanted to?

Mr. WILLETT. Sure, we could have picked a longer period. We picked the same period and we picked a period that happened to fit in these two States where there was the imposition, if you will, of an exclusive territory act. It happened that it was about midway between in Alabama, and it came a little bit later in the case of Missouri.

But in both cases we see very little change, roughly about two to 2½ percent, in prices each year in the case of both those States before and after exclusive territories; no major change.

I think the time period makes perfect sense. We have just been reacting to the period that Attorney General Abrams used, Senator.

Senator DECONCINI. Thank you. You have alluded to some other studies. Did you talk about the Michigan study? You did not have a chart on the Michigan study, did you?

Mr. WILLETT. Mr. Tollison did.

Mr. TOLLISON. Yes, we did.

Senator DECONCINI. Yes, the Michigan study. Were each of these studies, the Michigan study, Alabama study, and the other studies, completed with the intent of discovering the influence of territorial restrictions on beer prices, Mr. Tollison?

Mr. TOLLISON. I do not think so, no, not to my knowledge; the Alabama study, maybe, but the Michigan study was——

Senator DECONCINI. The ones that you did were not?

Mr. TOLLISON. Correct. I think they were concerned about declining tax revenues, if I remember correctly.

Mr. WILLETT. I think, frankly, the Michigan study had something to do with the social impact of beer prices and there was a concern that people were drinking too much if prices came down.

Senator DECONCINI. Can you elaborate on that?

Mr. WILLETT. That is about as much as I know about it, Senator, but it was done independently by a State agency. It had nothing to do with exclusive territories. It was done by the Public Health Agency of the State of Michigan.

Senator DECONCINI. But for a different reason than——

Mr. WILLETT. Totally different reason.

Mr. TOLLISON. Might I just say a word about the state of the art of these studies that have been referred to on my left?

Senator DECONCINI. Please do.

Mr. TOLLISON. Mr. Carstensen reminds me of a debate in the old Roman Senate where the senators were debating how many teeth there should be in a horse's mouth, and everybody got up and offered a theory that maybe it is pro-competitive, maybe it is anticompetitive, maybe it is efficiency-enhancing, maybe it is not.

Some lowly scribe in the back of the senate finally stood up and said, hey, why do you guys not go out and count the number of teeth in a horse's mouth if you want to know how many teeth are in a horse's mouth?

Now, to my knowledge, my study is the first serious attempt to do an econometric estimation of the impact of institutional factors on beer prices across U.S. States. I even threw a teaser in there for Mr. Carstensen in which I ran all other States against Indiana, which is the proper experiment in his terminology.

Lo and behold, my results got stronger. In fact, I can almost claim in a sense of statistical significance that prices are indeed higher in Indiana by 30 to 37 cents a gallon.

Now, if he wants that experiment, he can read my paper carefully, and I think it is in table 8. My professional guess is two-fold. One, if I am able to roll my data base backward into the era that he wants me to roll it back into, my results are only going to get better.

Now I find no difference in prices between the two kinds of States. If I can get a better data base in which there was a clear distinction, I am willing to make my professional judgment and bet a little money on it that I am going to find higher prices where they do not have exclusive territories.

Now I am willing to stake my professional judgment on that. I am working on this problem. I intend to publish this paper in a professional economics journal where it will undergo rigorous peer review.

So I will not have it dismissed as addressing the wrong problem. It is trying to count the number of teeth in the horse's mouth. How are beer prices determined across States? What are the factors that determine beer prices across States? And, lo and behold, what role do exclusive territories play in that process?

Senator **DeConcini**. Mr. Carstensen, have you read Mr. Tollison's study?

Mr. **Carstensen**. I got a chance to look at it when I arrived in town around 12:30. I looked at it quickly. I did notice the table that he referred to, and it struck me as having an interesting conclusion contrary to that drawn by Mr. Dee, the wholesaler from Indiana, which is that wholesalers ought to favor being in an open competition State. They seem to get higher prices, and as far as we know they have no greater service burdens. There is something anomalous there.

Senator **DeConcini**. Do you know of any study as comprehensive as this in the area?

Mr. **Carstensen**. I know that there are two other studies that I think you ought to pay particular attention to. I am reluctant because I am not an econometrician to compare them in terms of comprehensiveness. I have footnotes to both of these in my prepared statement.

One is the Jaffe-Jordan article in the Antitrust Bulletin which focuses on and comes to diametrically opposed conclusions with respect to the effect of——

Senator **DeConcini**. Is that based on a study?

Mr. **Carstensen**. Yes, and they have empirical data there. Even more interesting is an article in the Journal of Industrial Economics by Professors Baker and Breshnahan, I believe it is, which finds very substantial market power at the brewing level and concludes, based on their econometric work, that if any two brewers can collude together—and one effect of these territorial restraints is to greatly facilitate that—there would be significantly more harm to consumers.

Senator **DeConcini**. Well, if they did that, that would be a clear violation of the antitrust laws even if this legislation passed, is that right?

Mr. **Carstensen**. If it was done overtly and detected. As you may be aware, there is——

Senator **DeConcini**. Well, I am assuming that somebody enforces the law.

Mr. **Carstensen**. There is a lot of difficulty using the concept of tacit collusion when you start doing things as, again, the speaker—I think it was the gentleman from Massachusetts—pointed out the three beer wholesalers who have equal prices.

Senator **DeConcini**. Yes, but you are assuming that there would be very lax enforcement.

Mr. **Carstensen**. I make no——

Senator **DeConcini**. But if there was collusion between two major breweries, that would be a violation of the antitrust laws even if this legislation were passed, right?

Mr. **Carstensen**. Yes. But, again, the important point is that you ought to consider that article and what it tells you about the nature of competition in the industry.

[Supplemental statement follows:]

Supplemental Statement

Professor Peter C. Carstensen
University of Wisconsin Law School

Because I had had only a very limited time to review the Tollison-Ekelund (T-E) study prior to testifying at the hearing on S. 567, I was able then only to express my general concern about its conclusiveness in justifying Professor Tollison's claim that there are no price increasing effects associated with exclusive territories in beer distribution. As I have already explained in my statement and testimony, I strongly disagree with the implicit proposition that price changes standing alone are very relevant to the merits of this proposed legislation. Analysis of prices without parallel data on costs and changes in costs as well as services and changes in services provides only the most ambiguous information. For example, higher prices might be fully justified by greatly increased values received by consumers while lower prices might still be excessive relative to actual levels of productive costs and efficient distribution. However, having now examined the T-E study, I would like to comment, briefly, on it because its time series data suggests that exclusive territories do increase prices above what they otherwise would be and the cross sectional model is so questionable that it can not creditably refute that hypothesis.

The Time Series Data

As I point out in my testimony both T-E's Figure 6 (p. 20A) and Mr. Willett's data from Alabama show that real prices went up after territorial restraints were generally imposed in 1983. The Michigan data reported in the T-E study (Table 3, p. 18B) shows the same result for the late 1970's. Hence there is a consistent pattern: When prices before and after the actual imposition of vertical territorial restraints are compared, the post-restraint prices are higher. Three additional observations are important:

- Prices in T-E's Figure 6 are "real" prices deflated to 1967 levels. The 1983-1985 price increases that customers in fact paid were much greater. This is evident in the Michigan data, T-E Table 3, where an 8 cent "real" price increase constituted a 55 cent price increase in 1977-79 terms. Consequently, Figure 6 understates the price changes that customers would have observed in 1983-85.

- Any subsequent resumption of declines in real prices is still quite consistent with the territorial restraints having imposed and continuing to impose an excessive element in total price. The extent of that excessive cost would be the difference between what prices would have been in the absence of the restraint and the relatively higher level at which they in fact stood because of the added costs imposed on consumers by the restraint. A very hypothetical and casual application of this analysis to the Michigan data (i.e., assume that absent the restraints the cost reductions immediately prior to 1977 would continue over the next several years) would suggest that Michigan residents, despite lower real prices, were still paying as much as 10 (real) cents per six pack more than they would have paid absent the restraints.

- T-E provide no basis to believe that wholesaler services improved in 1983. In fact, they present other data which is much more consistent with classic cartelistic or monopolistic explanations for the observed price increases. Specifically, real prices increased in 1983 (see T-E Figure 6) despite an almost complete absence of growth in total demand for beer (see Carstensen Statement, Table 1). There was also entry by new brewers (T-E Figure 2, p. 8B) and expansion in sales volumes of imported beer, another substitute for the dominant domestic beers (T-E Figure 5, p. 18A). Such a pattern (price increases in the face of static demand, new entry and expansion by fringe producers) is consistent with cartelistic or monopolistic price increases which stimulate expansion of output by marginal competitors--of course neither the new entrants nor the imports represent more than a very small part of the industry volume--3 to 5 percent--and so do not constitute a threat to any cartelistic or monopolistic pricing that the dominant brewers and wholesalers may be employing.

The Cross Sectional Study

Professor Tollison's conclusion that exclusive territories have no price effect rests primarily on the T-E cross-sectional analysis. I am not an statistician and am not able to critique the mathematical aspects of this work. It does appear that this analysis may provide some important insights into the individual and cumulative effects of state restrictions on retailer competition. However, I strongly question whether it offers any relevant information about the effect of exclusive wholesaler territories on the price of beer. I have identified, so far, the following problems with the study:

1. The bulk of the statistical comparisons are between states which legally mandate exclusive territories and those which do not with respect to 1984 data. It is well known that most beer wholesalers in all states except Indiana have been subject to contracts restricting their territories since 1983 whether such restraints were mandated by state law or not. Hence, one would predict that the T-E study would find no difference in 1984 between the two classes of states and it did not.

2. Brewers engage in extensive price discrimination within and among states in the prices that they charge their wholesalers. The T-E study does not take account of this important variance in prices. Yet this is a vital variable in any effort to separate out the price effects of exclusive territories from other influences on the retail price of beer.

3. The study focuses exclusively on the retail price of beer yet, as Mr. Willett's response to the New York Attorney General's study suggests, retailers may have substantial independent power to influence final consumer prices. Indeed, the most useful aspect of the T-E study is its illumination of how restrictions on retail competition may increase consumer prices. In light of this information, however, it is essential to have data on the changes in wholesaler margins resulting from exclusive territories and how those changes relate to final retail prices.

4. The study does not include other important variables. It ignores the structure of brewing markets in different parts of the country and, more importantly, the structure of local wholesale markets which other information shows can be quite highly concentrated. It also ignores the differences in population dispersion among the states. Yet that will be an important factor in the costs of both wholesale and retail activities as the testimony from the Vermont and Massachusetts retailers suggested.

- Excluding important variables means that the resulting calculations may produce very misleading results. Such results may well associate the effect of the excluded variables with particular included variables giving a false impression of the real significance of the included variable. For example in Table 8, the only variable that uniquely distinguishes Indiana from the other 49 states is that which refers to territorial restraints; hence, if Indiana 1) differs substantially from the average for the country with respect to any of the excluded variables and 2) such a variable has an effect on retail price (prior Senate Hearings contain statements and data which suggest that population of particular cities is a very important factor in retail prices in those cities), it is probable that this effect would be associated with the only variable that is unique to Indiana in the T-E equation, i.e., the vertical territorial restraint variable. Consequently, any conclusions about the price effect of territorial restraints based on T-E's Table 8, which can not be very strong in any event, are also at best very suspect.

5. The T-E model finds that the most important factor in reducing prices is increased retail "congestion" which means reduction in the number of outlets that might sell beer for either off-premise or on-premise consumption.[1] This congestion idea makes sense only if one assumes that all outlets are of equal size. It is more logical to suppose that some states for some reasons (perhaps including regulatory ones) have larger scale retailers and that there are significant economies of scale in such businesses which are reflected in lower retail prices. However, it is also possible that this congestion factor may have some correlation with population dispersion or other important variables which were not separately included.

* * * * * *

In sum, the cumulative effect of (1) omitted but indispensable variables, (2) overly general and ambiguous variables, and (3) use of inapposite comparisons is that T-E's cross-sectional study is of very questionable value in appraising the price impact of exclusive territories. In contrast, the T-E time series data is consistent with the proposition that exclusive territories do cause an increase in prices over what would have existed in the absence of such restraints. Of course, as I have reiterated, price effects are only one part of the public policy question that this legislation poses. In my judgment, the public record as to price effects remains where it was when Richard Dahlson and I wrote our article: devoid of high quality empirical work on the specific price effects of these restraints . More importantly, however, the record remains even weaker with respect to the justification for these restraints.[2] There is still no convincing empirical evidence that they serve any valid efficiency function.

---

[1] T-E apparently include all retail and food and drink serving places in their index even though only some proportion, differing state by state depending on state and local licensing, will actually be outlets at which beer can be obtained. Moreover, it is not clear what relationship on-premise sales have to the retail prices, apparently for off-premise sales, which the regression equation seeks to explain.

[2] The service claims from the Vermont retailer, Mr. Henry, while suggestive of arguable benefits are also open to the interpretation that wholesalers charge high volume retailers excessive prices in order to subsidise service to low volume retailers. There is no efficiency justification for causing high volume retailers and their customers to subsidise small retailers and their customers. See, Carstensen, Dahlson, Vertical Restraints in Beer Distribution: A Study of the Business Justifications for and Legal Analysis of Restricting Competition, 1986 Wisc. L. Rev. 1, 36-38, 49-50.

Senator DECONCINI. I will consider that article.

Mr. TOLLISON. Senator, might I make a comment on market power in the beer industry?

Senator DECONCINI. Sure.

Mr. TOLLISON. I think we ought to keep a good bit broader perspective on what this industry is. Beer is not like oil. If you raise the price of beer, people are going to switch into other beverage products.

I think there is a fascination in antitrust circles to define things as narrowly as possible, to define markets for beer, for soft drinks, for juice, for milk, for tea, for coffee, and so on.

In fact, I think all of those commodities compete for the consumer dollar, and the kinds of results that you get in the literature suggesting that you have beer monopolists or potential for collusive gains among small numbers of beer producers, I think are simply an artifact of the refusal of people to believe that soft drinks compete with beer.

Now, I do not really have a lot of trouble with that. I do not have a lot of trouble with it in terms of my analysis of the industries and I do not have a lot of trouble with it when I open my refrigerator at night and in there I see beer and juice and soft drinks and tap water, and so on and so forth.

So I think if you put this industry in its proper competitive context, any of these problems with distributional arrangements or lack of competition at the brewer level look minuscule by comparison.

Senator DECONCINI. Mr. Tollison, just for the record, there is some question whether—and the same with you, Mr. Willett—there was a bias, since the National Beer Wholesalers Association commissioned it.

When you begin a study, does the fact that an individual organization is paying for it influence your findings, number one? What was your basis for using the formulas used in the study, and how did you determine what should be factored out, and are the techniques used in the studies fairly standard?

Mr. TOLLISON. Let me just say two things. I did this for NBWA, that is for sure. I have never had a more undirected consulting assignment in my life. They literally sent me to the Beer Institute where one Mr. Harold Katz was the repository of a lot of very valuable information and data about the industry.

I collected up the data, went home to George Mason, went to work with my assistants and tried to come up with some empirical understanding, some statistical understanding of what determines beer prices.

Senator DECONCINI. Outside of that information, did they come and talk to you and tell you what they wanted?

Mr. TOLLISON. No, no. They called me now and again and said, Tollison, when are you going to get this thing finished? But it was the most undirected project that I have ever been involved in.

With respect to the other kinds of things, I would just note for the record that at the end of my paper I print exactly all the public sources where I got my data and the page numbers, and I print my data.

So all those guys over at DOJ and all those PCs that you bought them and all those canned regression routines that you paid for can punch this data into their machines and decide if these results can be replicated, if they can add variables, delete variables, make this stronger, weaker, whatever. It is a very standard format in econometric estimation of price equations, demand equations.

So I am open to the world here. I open myself up completely; I am on the record. I welcome critical challenge.

Senator DECONCINI. Thank you, Professor. The study by the Consumer Federation of America, Professor Tollison, found that beer prices increased under exclusive territories. You believe this study was incorrect because it was flawed, I understand.

Can you tell us how the study was flawed and the effect of these flaws on the results of that study?

Mr. TOLLISON. Well, the two major shortcomings in Dr. Cooper's study are that the reported findings on prices are not statistically significant at anywhere near a standard level of statistical significance; that is, he, in effect, found no difference in prices across the two kinds of States. He found exactly what I found. So, in fact, he misreported that result as significant when it was not significant.

The other thing which is rather incredible is that he estimates a price equation for beer across States, and yet on the other side of that equation he did not enter beer consumption.

I would guess, and I do not mean this unkindly, that if Dr. Cooper gave that specification and those results in any economics department in the country as a seminar that he would have a very difficult time defending it.

Senator DECONCINI. Professor Tollison, since this legislation is similar to the Soft Drink Act of 1980, the effects of that legislation on the particular industry would be very helpful.

Briefly, what have been the economic effects of that legislation on prices in that industry, and is it safe to compare these industries?

Mr. TOLLISON. I think it is. Their distribution systems are fairly similar. There are some differences in the issue of concentrate supply to bottlers, and so on and so forth.

I should note that I have done a rather extensive study of the soft drink industry in connection with Pepsico's attempted acquisition of Seven-Up. I was retained by Pepsico. I argued before the Federal Trade Commission that this acquisition was pro-competitive, and the primary basis of my argument was, again, that soft drinks are ensconced in a very competitive environment and that virtually every bit of evidence that you can get about the behavior of that industry over the last 5, 10, 15, 20 years and its forecasted future is that it is increasing output and the real price of soft drinks is coming down.

So bottling cases to the contrary notwithstanding, I think they do not teach us very much. We do not know——

Senator DECONCINI. There is no reason in your professional judgment to think that if this legislation was enacted the same thing would not happen in this industry that happened in the soft drink industry?

Mr. TOLLISON. In answer to one of Senator Metzenbaum's stock questions to the audience, I do believe in antitrust, but I believe in the intelligent application of antitrust. The intelligent application of antitrust is not spurious litigation by competitor against competitor or by a poor distributor who happens to get terminated for doing a poor job.

That is not an intelligent use of the Sherman Act; that is not an intelligent use of the Clayton Act. An intelligent use is to go after horizontal conspiracies that do raise prices and do harm consumers. That would be my answer.

I think this legislation, like the soft drink legislation, forces private litigation in antitrust into a more productive channel and gets it out of unproductive channels.

Senator DECONCINI. Thank you, gentlemen, very much. You have been very helpful. Yes, sir, Mr. Willett.

Mr. WILLETT. Senator, I would just like to say one thing. You asked both of us a question about independence.

Senator DECONCINI. Yes.

Mr. WILLETT. I would respond the same way for Grant Thornton. All studies we do are totally independent.

Senator DECONCINI. Thank you. I am sorry. I forgot to give you an opportunity to do that.

Ladies and gentlemen, that is going to conclude the hearings here. Indeed, they have been very extensive and I think we have made a very sound record here in opposition and in favor of the legislation.

I want to thank Mr. Carstensen, Mr. Tollison and Mr. Willett for staying here during the other panels that were before them, and indeed your testimony has been extremely helpful.

Without objection, the statement of the Senator from Utah, Mr. Hatch, will appear in the record at this time.

[Prepared statement follows:]

PREPARED STATEMENT OF SENATOR ORRIN G. HATCH

Mr. Chairman, I commend you for holding a hearing on this important legislation. S. 567 provides a threshold standard for determining the legality of vertical nonprice restrictions on the distribution of malt beverages. In fact, S. 567 provides an identical clarification of antitrust laws with respect to nonprice vertical restraints as Congress granted the soft drink industry in 1980.

During the time this bill and indentical bills from prior Congresses have been examined, critics of this legislation have contended that passage of this legislation would cause an increase in prices due to reduced competition. However, a careful examination of the studies of changes of prices in States that have required or prohibited territorial contracts, throw into question these claims that S. 567 will have an anticompetitive affect.

Mr. Chairman, there is a great deal of confusion surrounding these issues. I look forward to hearing the testimony of these knowledgeable witnesses as I am certain that their contribution will shed light on these questions.

Senator DECONCINI. We also have a statement from Mr. Hank Graham of the Arizona Licensed Beverage Association which will appear in the record.

[Prepared statement follows:]

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ARIZONA LICENSED BEVERAGE ASSOCIATION, INC.
OFFICE – 2310 NORTH 15TH AVENUE – SUITE 11 • PHOENIX, ARIZONA 85007 • Telephone (602) 258-8953

AFFILIATED WITH: NATIONAL LICENSED BEVERAGE ASSOCIATION; NATIONAL LIQUOR STORES ASSOCIATION; DISTILLED SPIRITS COUNCIL OF THE U.S.

27 July, 1987

The Honorable Howard M. Metzenbaum, Chairman
Subcommittee on Antitrust, Monopolies and Business Rights
Room 308, Hart Senate Office Building
United States Senate
Washington, DC 30510

Dear Mr. Chairman:

This is to advise you that the Arizona Licensed Beverage Association strongly supports enactment of S.567, the Malt Beverage Interbrand Competition Act. Our retailers depend on deliveries of malt beverages in a timely and reliable manner, even though many purchase only modest quantities. The margin to the wholesaler from these accounts, I suspect, is minimal and in some cases might well be negative. If exclusive territory contracts with their requirements to service all retail outlets regardless of size at non-discriminatory prices were not in use, some of these small taverns could be forced to close their doors.

Large retailers may be able to survive, for a time, in a dog-eat-dog situation where large food chains with their ability to attract large-volume discounts would likely drive many smaller retailers and wholesalers out of business. Some might argue that such a result is the price of competition. We believe that the ultimate result would be a concentration of purchasing power in a few large corporations, with a corresponding increase in the power to control retail prices.

The three-tier system is absolutely essential to tavern operators. Beer is a perishable commodity. The scrupulous attention to stock rotation by our wholesalers to insure freshness is a very important service.

As to the charge that consumer prices will rise under exclusive territories, it just has not happened here in Arizona. Malt beverages are highly price elastic. If Budweiser gets too expensive, our customers quickly switch to another less costly brand. We agree with the conclusion reached by many economic researchers that exclusive territories enhance competition, and do not result in higher prices.

We are deeply perplexed and saddened by the stand taken by the National Licensed Beverage Association in opposition to this bill. I and many of our members have reviewed the NLBA testimony. It's pleading seems more in line with legal theorists than with the workaday concerns of tavern owners, namely, how do we get our beer and how do we keep the taps clean and flowing?

In conclusion, we reiterate our need for and dependence on malt beverage wholesalers. Their function of timely delivery, reliable service, stock rotation, promotions, and servicing of draft beer apparatus is one which is essential to our livelihood and one which our members would be in a poor position to assume on their own. Enactment of S.567 will ensure the continuation of this healthy relationship. I request that this letter be made part of the hearing record.

Respectfully,

Hank Graham

Mr. Hank Graham, President
ARIZONA LICENSED BEVERAGE ASSOCIATION

cc: Honorable Dennis DeConcini

Senator **DeConcini**. This Senator again thanks Senator Metzenbaum and his staff for permitting us to conduct these hearings and proceeding with them in an expeditious manner.

The subcommittee will stand in recess, subject to the call of the Chairman.

[Whereupon, at 5:01 p.m., the subcommittee was adjourned.]

APPENDIX

United States Senate
COMMITTEE ON THE JUDICIARY
WASHINGTON, DC 20510-6275

JOSEPH R. BIDEN, Jr., DEL., CHAIRMAN
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EDDIE CORREIA, CHIEF COUNSEL AND STAFF DIRECTOR
KENNETH E. STARLING, MINORITY CHIEF COUNSEL

September 17, 1987

Mr. Robert C. Brook
Administrator
Office of Substance Abuse Services
3423 N. Logan
P.O. Box 30035
Lansing, Michigan 48909

Dear Mr. Brook:

The Subcommittee on Antitrust, Monopolies, and Business Rights of the Senate Judiciary recently held a hearing on a proposed bill entitled the Malt Beverage Interbrand Competition Act of 1987, S. 567. This bill would exempt beer wholesalers from the ordinary treatment of industries under the antitrust laws.

During the hearing, reference was made to a study from Michigan.

> Evidence as to whether or not the use of territorial restrictions in the distribution of beer enhances consumer welfare can be obtained by examining the effects of such non-price restraints on retail beer prices in those states which mandate exclusive territories versus retail beer prices in other jurisdictions. One bit of evidence in this regard comes from the experience of Michigan, a state where a law requiring the assignment of exclusive beer distribution territories took effect in January 1977. A study by the Michigan Department of Public Health showed that from 1967 to 1983, the prices of beer sold in Michigan declined relative to those of most consumer goods. In constant dollar terms, a six-pack of beer that cost Michigan's consumers $1.23 in 1967 cost only 91 cents in 1983. More importantly from the standpoint of S. 567, real beer prices in Michigan declined from $1.04 a six pack in the year before the exclusive territory law to 91 cents a six pack in 1983, seven years later. This price decline would not have been possible had

> exclusive beer distribution territories in Michigan worked to the detriment of consumer welfare. On the contrary, beer prices in Michigan clearly continued their steady downward trend following the passage of exclusive territory legislation. Indeed, on the basis of its independent study the Department of Public Health concluded that the performance of beer prices in the state represented "an enviable business achievement by beer manufacturers."

Statement of Dr. Robert D. Tollison, Professor of Economics, George Mason University concerning S. 567, August 4, 1987, before the Subcommittee on Antitrust, Monopolies, and Business Rights, Committee on the Judiciary, United States Senate at pp. 2-3.

Would you please comment on the accuracy of this testimony and send the Subcommittee a copy of the study it references? In addition, I would appreciate your response to the following questions:

1. What role, if any, did the Michigan Department of Public Health, or any other Michigan agency, play in this study?

2. Was the referenced study an "independent" study of a Michigan agency?

3. Was the purpose of the study to address the effect, if any, of exclusive beer distribution territories on the price of beer? If not, what was the purpose of the study?

4. Does the Michigan Department of Public Health have an official position on the efficacy of exclusive beer distribution territories? If so, what is the Department's position?

Thank you very much for helping the Subcommittee in this matter. If you have any questions about this inquiry, please contact Priscilla Budeiri of my staff at (202) 224-5701.

Sincerely yours,

[Signed]
Howard M. Metzenbaum
United States Senator

STATE OF MICHIGAN

JAMES J. BLANCHARD, Governor
OFFICE OF SUBSTANCE ABUSE SERVICES
3423 N. LOGAN, P.O. BOX 30035
LANSING, MICHIGAN 48909
ROBERT C. BROOK, Administrator

November 13, 1987

Congressman Howard M. Metzenbaum
Chairman, Subcommittee on Antitrust,
Monopolies and Business Rights
United States Senate Committee on
the Judiciary
Washington, D.C. 20510-6275

Dear Senator Metzenbaum:

This letter is in response to your September 17, 1987 request for my comments on testimony by Dr. Tollison before your subcommittee regarding S. 567.

Dr. Tollison's testimony apparently referred to a report written by a member of my staff and me. The report is entitled, "An Analysis of Michigan Beer Prices and Revenues: Policy Opportunitites and Their Impact on the Public." A copy of this 1985 report is enclosed.

Although Dr. Tollison's testimony accurately reflects data and statements in our report, they are taken out of context. His testimony gives the incorrect impression that we studied the effects of exclusive territorial distributorships on beer prices, which we did not.

Our study focused on the relationships among beer prices, excise tax revenues, and alcohol-related problems. I believe there is a relationship between prices and consumption levels, and, as a public health official, I advocate higher taxes and higher beer prices as a means of reducing consumption. Lower per capita consumption will result in lower levels of alcohol-related health damages among all citizens but especially the youth. I must stress that we did not study exclusive distributorship territories and our study, or selected portions of it, should not be taken by your subcommittee as supporting evidence for exclusive territories for beer distributors.

I especially want to correct the impression given by Dr. Tollison's quote from our study that maintaining low beer prices "is an enviable business achievement." Taken out of context, as it was, this statement presents us as favoring low beer prices. As I said earlier, I advocate exactly the opposite.

I appreciate your diligence in checking Dr. Tollison's testimony and hope that my comments will correct any misleading impressions that his testimony may have created.

Sincerely,

Robert Brook

Robert C. Brook, Ed.D., M. Div.
Administrator

Enclosure

AN ANALYSIS OF MICHIGAN BEER PRICES AND REVENUES: POLICY OPPORTUNITIES AND THEIR IMPACT ON THE PUBLIC

Mark Steinberg, M.A.

and

Robert Brook, B.D., Ed.D., C.Psych.

MICHIGAN OFFICE OF SUBSTANCE ABUSE SERVICES
DEPARTMENT OF PUBLIC HEALTH

July, 1985

AN ANALYSIS OF MICHIGAN BEER PRICES AND REVENUES: POLICY OPPORTUNITIES AND THEIR IMPACT ON THE PUBLIC

Mark Steinberg, M.A.*

and

Robert Brook, B.D., Ed.D., C.Psych.

MICHIGAN OFFICE OF SUBSTANCE ABUSE SERVICES
DEPARTMENT OF PUBLIC HEALTH

July, 1985

Mr. Steinberg is senior policy analyst for the Office of Substance Abuse Services. Requests for reprints should be addressed to him. Dr. Brook is a psychologist and Administrator of Substance Abuse Services for the State of Michigan. For further information, contact Mr. Steinberg at the Office of Substance Abuse Services, Michigan Department of Public Health, 3423 N. Logan, P. O. Box 30035, Lansing, MI. 48909 or phone (517) 373-7668.

ABSTRACT

This paper argues that the Michigan beer tax should be raised, for three principle reasons:

1. Over the past several decades, beer prices have declined relative to the Michigan Consumer Price Index (CPI) and relative to disposable income. Since lower retail prices on alcohol tend to encourage higher rates of excessive consumption among the population as a whole, this trend poses appreciable risk to the public's health and safety.

2. During the same time period, State revenues from beer sales have not kept pace with inflation. This means that, in effect, the State has lost money. The amount is hundreds of millions of dollars.

3. The dollar costs of alcohol problems have increased over time at a rate at least equal to inflation. All told, the price tag on these problems far exceeds State alcohol revenues, and the gap is increasing. It is only sensible to take steps to try to balance the economic benefits and the economic loss generated by the sale and consumption of alcohol.

The paper suggests three ways to help remedy these problems. First, the people of Michigan could adopt a policy of indexing retail beer prices to the annual inflation rate. Second, the beer excise tax could be indexed to the inflation rate. And third, the beer tax could be raised so as to be equivalent to the current State tax on distilled spirits. Adoption of any one of these policies would have two immediate benefits:

1. Millions of dollars of additional revenues would be obtained each year. A portion of these revenues could be returned to our communities to support alcohol abuse treatment and prevention efforts, and other important health services.

2. These adjustments would help keep relative retail prices from falling, and thereby lessen economic inducements to drink excessive amounts of alcohol.

For the large majority of citizens, moderate and gradual increases in the beer tax would require little or no increase in annual expenditures for beer. One third of Michigan adults use no alcohol at all. Another third use very little alcohol, up to three drinks a week. Another 20% of adults are moderate drinkers, consuming no more than 13 drinks a week. Only the heavier drinkers (about 10% of the adult population), people who drink consistently at unhealthy and unsafe levels, would experience notable increases in annual alcohol expenditures.

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AN ANALYSIS OF MICHIGAN BEER PRICES AND REVENUES: POLICY OPPORTUNITIES AND THEIR IMPACT ON THE PUBLIC

INTRODUCTION

Since the early 1950s, the retail prices of beverage alcohol products have increased at a slower rate than the overall inflation rate. Because the prices of beer, wine, and distilled spirits have risen more slowly than the prices of other consumer goods and services, alcohol products have become a "better buy" over time. And as the price of alcohol products has not kept pace with increases in personal disposable income, alcohol has in fact become steadily less expensive. These trends are true for Michigan and for the United States as a whole.

There are several reasons for the relative decline in alcohol prices. These include improvements in manufacturing processes, lower labor costs, lower costs of raw materials, and greater economy of scale due to fewer manufacturers achieving larger shares of the consumer market. Another reason is that federal and state taxes on alcohol products have been fairly flat over time.

The decline in alcohol price has had two important implications for Michigan. One is that the low relative price of alcohol products has tended to encourage people, in aggregate, to purchase and consume more alcohol. Higher aggregate levels of alcohol consumption, in turn, have led to higher levels of alcohol-related damage. The relationships between price, consumption, and damage hold for Michigan and for numerous other large jurisdictions as well, as reflected in a growing body of scientific research.(1) Price alone, of course, is not the sole determinant of how much alcohol a population as a whole will buy. Other factors are also important. These include personal income, advertising and promotion of alcohol products, numbers of retail outlets, hours of sale, and social norms regarding alcohol use, among other factors. But price, or the economic availability of alcohol products, is among the most influential.(2)

The second implication is lost revenue. Because Michigan taxes have lagged well behind the general rate of inflation, the State of Michigan has in effect lost substantial amounts of revenue, totaling in the hundreds of millions of dollars.

The following pages present an examination of these trends. Although the relationships between price, consumption, and alcohol-related damage apply to beer, wine, and spirits, and although the State has lost considerable revenue potential on all three products over the years, this paper focuses on beer as an illustration of these trends. Beer was chosen for three reasons. First, beer has been the most popular alcoholic product in Michigan. In terms of gallons sold, beer has outranked wine and distilled spirits over the years. And in terms of ethanol consumption, (ethanol, or absolute alcohol, is the active ingredient in all alcohol products) beer is strongly ahead of spirits and wine.(3)

Figure 1

1982-83 MICHIGAN ALCOHOL SALES

Beverage	Total Gallons	Total Gallons Ethanol	Ethanol as % of Sales
Beer	215,348,041	9,259,965	51.4%
Spirits	16,843,530	6,905,847	38.3%
Light Wine	15,165,276	1,819,833	10.1%

A second reason for focusing on beer is that beer excise tax losses have been greater than losses on spirits sales. Beer taxes are set at a flat rate, $6.30 per 31-gallon barrel (the equivalent of just over 55 six-packs). Tax revenues are independent of how much the barrel sells for at retail. Spirits taxes are *ad valorem*, based on how much the State has to pay for each bottle. The State marks up each bottle by 51% of the State's purchase cost, then adds on three separate specific taxes, totaling 9.85%. Thus, when the retail prices of spirits pjroducts go up, so do State tax revenues. Beer tax revenues do not increase as beer costs/prices increase, and so are subject to greater inflationary erosion. Under Michigan's current tax policy, the only way beer excise tax revenues can *not decline*, given inflation, or can increase, is for sales and drinking levels to increase.

Wine is also taxed at a flat rate (13.5 cents per liter, or 50 cents per gallon). Wine sales and revenues are much lower than those for beer, so beer makes for a more striking analysis.

Third, because beer is taxed at a flat rate, economic analysis is far simpler and more straightforward compared to the more complex structure of spirits taxes.

HISTORY OF MICHIGAN BEER EXCISE TAXES

In 1933, an excise tax of $1.25 per 31-gallon barrel was established. This held until 1960, when the tax was increased to $2.50/bbl. In 1961, it reverted to $1.25/bbl, then increased again in 1962 to $6.613/bbl. This rate was maintained until 1966, when the tax was lowered to $6.30/bbl. Since 1966, the Michigan beer excise tax has held steady at $6.30/bbl. In terms of retail prices, this tax translates to a constant 11.4 cents per six-pack of beer from 1966 through to the present. All beer excise tax revenues are deposited in the State General Fund.(4)

BEER PRICES, STATE REVENUES, AND INFLATION

The overall price of consumer goods in Michigan increased nearly 300% from 1967 to 1983. Disposable income rose from $2,913 to $9,725, a 230% increase. However, retail beer prices increased by only 220%, meaning that beer prices have declined relative to other products and to the amount of money people have to spend. Over time, beer prices have become comparable to or lower than prices for soft drinks and fruit juices. It must be questioned whether this is a healthy situation for the population as a whole.

Figure 2 shows price, revenue, and inflation trends in Michigan from 1967 through 1983.(5) The 1967 starting point is taken because this is the year set by the federal government as the most recent base year for calculating the consumer price index (CPI).

State beer tax revenues increased 18.84% from 1967 to 1983. Because 1983 dollars are worth considerably less than 1967 dollars, this represents a decline in revenue over time. Michigan's beer excise tax revenues have declined in value between 1967 and 1983. The 1983 revenues of $43,666,960 are worth $14,727,474 in 1967 dollars. To have kept even with inflation, 1983 revenues should have totaled $109,275,552. This means that there was an income loss of $65,608,592 *in 1983 alone.*

During this same time period, it is clear that increases in beer retail prices lagged behind overall inflationary increases. While the price of a six-pack rose 220% over the 16 years, consumer prices in general rose by 296.5%. Retail beer prices dropped, in effect, over time. In 1967 dollars, a six-pack that cost $1.23 in 1967 cost only 91 cents in 1983. Put another way, if the price of a six-pack had kept pace with inflation, it would have risen to $3.65 by 1983 ($1.23 x 2.965). This is nearly one dollar over the actual 1983 price of $2.71 (Figure 2). *That beer prices have*

Figure 2

(2.cal/202)

MICHIGAN BEER PRICES, REVENUES, AND INFLATION, 1967-1983

YEAR	BARRELS SOLD	BEER EXCISE TAX REVENUE	Tax Revenue in 1967 dollars	MICHIGAN CPI	PER CAPITA DISPOSABLE INCOME	MICHIGAN BEER CPI	SIX-PACK RETAIL PRICE TAKE-OUT	SIX-PACK PRICE IN 1967 DOLLARS
1967	5,832,648	$36,855,161	$36,855,161	100.0	$2913	100.0	$1.23	$1.23
1968	5,855,414	$36,741,982	$35,227,212	104.3	$3133	102.8	$1.26	$1.21
1969	5,829,861	$37,315,892	$33,739,505	110.6	$3311	105.4	$1.30	$1.18
1970	6,302,456	$38,466,376	$32,765,227	117.4	$3423	108.9	$1.34	$1.14
1971	6,310,608	$39,547,160	$32,495,612	121.7	$3719	112.9	$1.39	$1.14
1972	6,507,834	$40,784,125	$32,317,056	126.2	$4017	113.9	$1.40	$1.11
1973	6,443,063	$40,702,070	$30,261,762	134.5	$4506	115.6	$1.42	$1.06
1974	6,805,882	$42,207,094	$28,307,910	149.1	$4823	126.8	$1.56	$1.05
1975	7,019,820	$44,473,106	$27,743,672	160.3	$5153	140.3	$1.73	$1.08
1976	6,971,085	$43,685,361	$25,864,631	168.9	$5699	143.1	$1.76	$1.04
1977	7,431,961	$46,198,769	$25,609,074	180.4	$6340	147.2	$1.81	$1.00
1978	7,301,175	$45,875,704	$23,635,087	194.1	$7060	160.0	$1.97	$1.01
1979	7,012,142	$43,962,254	$20,092,438	218.8	$7750	191.5	$2.36	$1.08
1980	7,005,853	$43,887,440	$17,312,600	253.5	$8348	210.5	$2.59	$1.02
1981	6,960,258	$44,012,367	$15,883,207	277.1	$9208	222.2	$2.73	$.99
1982	6,849,518	$44,709,253	$15,507,892	288.3	$9214	215.3	$2.65	$.92
1983	6,946,711	$43,666,960	$14,727,474	296.5	$9725	220.0	$2.71	$.91

not been subject to general inflationary increases may be an enviable business achievement by beer manufacturers. But this achievement has been costly to the citizens of Michigan, in terms of lost State revenues and in terms of greater risks to public health and public safety.

ALCOHOL REVENUES AND ALCOHOL-RELATED COSTS: DIVERGING TRENDS

In pharmacological terms, alcohol is classified as an ambivalent drug. This means that, with respect to its effects on human beings, alcohol is neither a good nor a bad drug, neither beneficial nor harmful. The effects of the drug can go either way depending on how much of it is used, and the way in which it is used.

Michigan and all other state governments implicitly recognize this ambivalence. On the one hand, our policy-makers recognize that alcohol use generates important social and economic benefits. Many businesses rely heavily on the sale of alcohol, and governments themselves bring in large amounts of alcohol-related revenues. In fact, the appeal of tax revenues from the sale of alcohol was a major argument for the repeal of Prohibition in the early 1930s, and was a major reason for the states becoming heavily involved in controlling the alcohol marketplace.

On the other hand, there is the recognition that alcohol has a very high abuse potential. Alcohol is a drug with toxic and intoxicating properties, and is widely available. Some level of abuse, and therefore some level of human, social, and economic damage is inevitable. For these reasons, restrictions have been placed on its distribution, marketing, sales, purchase, and use.

A review of the large number of laws and rules currently in effect in Michigan shows that our public policy on alcohol has a dual preoccupation with protecting public health and public safety and maintaining an orderly and profitable marketplace.(6)

The government's objective, then, should be to achieve a balance between the harmful and the beneficial aspects of alcohol. Since as a society we have chosen to accept alcohol as a legal drug, we have an ethical and a pragmatic responsibility to assure that benefits outweigh damages, or, at worst, to assure that they are equal. One estimate of whether a reasonable balance has been achieved can be obtained by comparing the economic costs of alcohol abuse against the economic benefits of alcohol sales in Michigan. The major advantage of this comparison is that assets and deficits are quantifiable in a common unit, dollars.

In 1983, the Office of Substance Abuse Services commissioned a study of the economic costs of alcohol abuse in Michigan. The result was a report that estimated the total cost in 1982 at 1.412 billion dollars.(7) Calculations were based on a national model developed in 1977. The authors of the report suggested that annual statewide costs from 1977 forward would vary more with inflation than with variations in problem levels over this relatively short time period. The alcohol-related damage costs for 1977 through 1983 are indicated in Figure 3. The yearly costs are derived from the 1982 cost and adjusted for the Michigan Consumer Price Index (CPI).

We are not aware of any comprehensive estimate of Michigan's alcohol-related dollar benefits. The only estimate of dollar benefits available to us is the Michigan Liquor Control Commission's (MLCC) statements of net annual revenue, published in the yearly "Statistical Look" documents. These data reflect the state's net earnings directly from the sale of alcohol, including beer, wine, and spirits taxes (Figure 3). These data are, of course, only a portion of alcohol-related revenues. Not included, for example, are revenues generated by the thousands of businesses and the thousands of employees whose incomes derive in whole and part, directly and indirectly, from the sale of alcohol. Therefore, the MLCC's net revenue figures represent a significant underestimate of total revenues.

Even if a total revenue estimate were available, however, it would have to be adjusted downward by the dollar amount which the State and Federal governments contribute to the alcohol industry in the form of tax subsidies. The U.S. tax code provides liberal allowances for the deduction of alcohol purchases as business-related expenses. It also allows alcohol advertising costs to be counted as business expenses. These tax policies subsidize personal alcohol consumption and corporate alcohol promotion in the amount of over 5 billion dollars a year.(8)

Figure 3

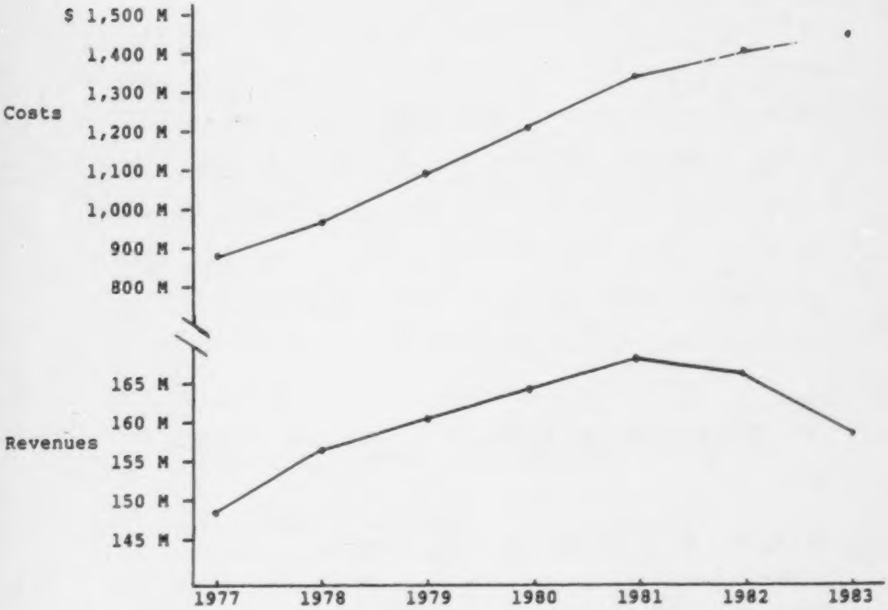
COMPARISON OF MICHIGAN ALCOHOL TAX REVENUES AND ALCOHOL-RELATED COSTS: 1977-1983

Years	Estimated Cost of Alcohol-Related Damage	Total Net Alcohol Revenues (beer, wine and spirits)	Inflation-Adjusted Revenues
1977	$883,540,756	$147,916,858	$81,993,824
1978	950,638,917	156,174,708	80,460,952
1979	1,091,303,515	160,273,220	73,251,015
1980	1,241,560,874	164,654,653	64,952,526
1981	1,357,146,028	168,280,835	60,729,280
1982	1,412,000,000	167,485,369	58,094,127
1983	1,452,160,943	159,358,230	53,746,452

(4.fig/202)

Figure 4

ALCOHOL REVENUES AND ALCOHOL-RELATED DAMAGE COSTS FOR MICHIGAN: 1977-1983
(in millions of dollars)



Revenues are total annual net revenues collected by the Michigan Liquor Control Commission. Damage costs are estimated annual economic costs arising from excessive alcohol consumption. Cost factors include illness, injury, lost production, death, and other factors.

Despite these limitations, useful information can be derived from the comparison. Most importantly, revenues have increased only 8% over these seven years, while costs have increased 75%. When revenues are converted to 1967 dollars to adjust for inflation, revenues have actually decreased 34% (Figure 3).

While revenues have lagged behind inflation, costs have increased with inflation. The components of alcohol-related costs (e.g., alcoholism treatment, law enforcement, decreased employee productivity, etc.) are subject to inflationary increases. A major component, medical services, has risen more steeply than the overall CPI in recent years. As a result, Michigan has incurred a large and growing deficit with respect to alcohol revenues and costs. For our state, the alcohol business has been a money-loser.

Based on the available data, Michigan has experienced diverging trends in alcohol-related costs and revenues (see Figure 3 and Figure 4). Costs are rising, and revenues are declining. Michigan has not achieved a reasonable balance between alcohol-related harms and benefits. Fortunately, there are readily available methods for improving this situation.

BALANCING COSTS AND REVENUES

There are two primary ways to bring alcohol-related costs and revenues into a more acceptable balance. One way is to reduce costs. The other is to increase revenues.

Several initiatives are under way to reduce the number and seriousness of alcohol problems and their costs. These include on-going treatment efforts, public information campaigns, the newly developed Michigan School Health Education Project, the Michigan Licensed Beverage Association's Techniques of Alcohol Management program, drunk driving countermeasures, and health care cost-containment measures, to cite a few.

Revenues may be increased by increasing the volume of alcohol sales and by increasing income per sale. Increasing beer sales volume is not an acceptable option: the increased alcohol consumption that would follow would generate increased levels of damage, thus increased costs. Such a policy would be fiscally unsound. For example, if 10,000 additional six-packs of beer were sold, the state would receive $1,140 in additional excise tax revenues. These gross revenues would be more than wiped out by the public costs alone of a single drunk driving crash. It is ethically indefensible for the State to deliberately seek to increase its revenues when the mechanism for generating those profits will result in serious damage to its citizens.

The only reasonable and efficient way to achieve revenue enhancement is to increase the amount of money the State General Fund makes on each sale. The remainder of this paper explores three ways this might be done, and then looks at the implications of adopting one or more of these revenue enhancement measures.

THREE WAYS TO ENHANCE BEER TAX REVENUES

Price and revenue decreases can be curtailed in at least three ways. Each of these can be illustrated by showing how prices and revenues might have been affected if the method had been implemented in earlier years.

First, the State could have adopted a policy of ensuring that beer did not become cheaper over time. Price decreases could have been prevented by making annual adjustments in the excise tax rates to correct for disparities between retail prices and the CPI. That is, the State could have engineered retail price increases commensurate with the overall inflation rate.

Second, the State could have adjusted excise tax rates each year according to the overall inflation rate. This is a more moderate approach, in that it would have a lesser impact on retail prices, but it would prevent inflationary erosion of state revenues over time.

Third, the State could have opted to increase the beer tax rate by making the beer tax equivalent to the taxes on distilled spirits. This could have been done by taxing each beverage according to its ethanol (absolute alcohol) content.

None of these approaches is new or extraordinary. They have been proposed and explored frequently by noted economists and by scientists in the public health field.(9) Successful implementations of one or a combination of the three approaches would improve the health and safety of Michigan's citizens, and would improve the State's fiscal condition.

PRICE INDEXATION: ADJUSTING RETAIL PRICES FOR INFLATION

How would beer prices and state revenues have been affected by a policy of keeping retail prices in line with general inflationary trends? A method to achieve this involves determining the difference between the previous year's retail price and what the price would have been had it risen with the CPI, then adjusting the current year's excise tax level to make up for the difference. For example, from 1967 to 1968, the price of a six-pack in Michigan rose $.03, from

$1.23 to $1.26. If this price increase had corresponded to the CPI, the price would have risen to $1.28, two cents more. To create a two cents per six-pack price increase, the beer excise tax would have been upped to $7.40 per barrel, in 1969. All tax adjustments have to be on a one-year lag basis, so as to be able to compare beer price changes with CPI changes for the previous year.

Had this method been employed since 1967, the retail price of a six-pack of beer (excluding deposit and sales tax) should have been $3.65 in 1983. The estimated actual 1983 price is only $2.71, a difference of 94 cents. The beer excise tax per barrel should have increased to $55.91, and the 1983 beer excise tax revenue would have been $320 million dollars. In comparison, the actual revenue for 1983 was only $43,666,960. Over this entire period (1967-1983), just over 1.5 billion dollars in additional revenues could have been earned to the State General Fund.

The above estimates take into account that beer sales would decrease somewhat due to increases in price. This involves the concept of price elasticity of demand, which bears on the relationship between changes in price and changes in consumer purchasing levels. Beer is regarded as a price inelastic

(S.cal/202)

Figure 5

ECONOMIC IMPLICATIONS OF ADJUSTING MICHIGAN BEER PRICES TO THE RATE OF INFLATION

YEAR	MICHIGAN BEER CPI	SIX-PACK RETAIL PRICE TAKE OUT	MICHIGAN OVERALL CPI	RETAIL PRICE ADJUSTED TO OVERALL CPI (DIFF FROM ACTUAL)	PER BARREL EXCISE TAX ADJUSTMENT (one year lag)	ACTUAL BEER EXCISE TAX REVENUE	ADJUSTED BEER EXCISE TAX REVENUE	DIFF BETWEEN ACTUAL AND ADJUSTED
1967	100.0	$1.23	100.0	$1.23 (0)	$6.30	$36,855,161		
1968	102.8	$1.26	104.3	$1.28 ($.02)	$6.30	$36,741,982		
1969	105.4	$1.30	110.6	$1.36 ($.06)	$7.40	$37,315,892	$42,148,729	$4,832,837
1970	108.9	$1.34	117.4	$1.44 ($.10)	$9.61	$38,466,376	$58,265,071	$19,798,695
1971	112.9	$1.39	121.7	$1.50 ($.11)	$11.81	$39,547,160	$71,547,149	$31,999,989
1972	113.9	$1.40	126.2	$1.55 ($.15)	$12.36	$40,784,125	$76,012,803	$35,228,678
1973	115.6	$1.42	136.5	$1.65 ($.23)	$14.57	$40,702,070	$86,365,394	$45,663,323
1974	126.8	$1.56	149.1	$1.83 ($.27)	$18.98	$42,207,094	$118,195,711	$75,988,617
1975	140.3	$1.73	160.3	$1.97 ($.24)	$21.18	$44,473,106	$138,272,202	$93,799,096
1976	143.1	$1.76	168.9	$2.08 ($.32)	$19.52	$43,685,361	$123,828,777	$80,143,416
1977	147.2	$1.81	180.4	$2.22 ($.41)	$23.94	$46,198,769	$157,460,215	$111,261,446
1978	160.0	$1.97	194.1	$2.39 ($.42)	$28.90	$45,875,704	$188,848,542	$142,972,838
1979	191.5	$2.36	218.0	$2.69 ($.33)	$29.45	$43,962,254	$192,052,051	$148,089,797
1980	210.5	$2.59	253.5	$3.12 ($.53)	$24.49	$43,887,440	$154,416,006	$110,528,566
1981	222.2	$2.73	277.1	$3.41 ($.68)	$35.51	$44,012,367	$216,512,486	$172,500,119
1982	215.3	$2.65	288.3	$3.55 ($.90)	$43.78	$44,709,253	$248,893,675	$204,184,422
1983	220.0	$2.71	296.5	$3.65 ($.94)	$55.91	$43,666,960	$320,422,255	$276,755,295

commodity. This means that given an x% increase in price, sales will decrease less than x%. A number of different elasticity estimates have been published using national data. In this paper, a recent Michigan estimate is used, which holds that for every 10% increase in retail price, there will be a 5% decrease in sales.(10) Even though sales would decline at the 10%/5% ratio, revenues would still increase substantially for a given year and over time.

TAX INDEXATION: ADJUSTING THE BEER TAX RATE FOR INFLATION

A second method is to adjust the beer tax rate annually, based on the previous year's Michigan CPI. This method would have a lesser effect on tax rates and retail prices than price indexation. However, it would dampen artifical economic incentives to consume alcohol, and it would prevent State beer tax revenues from shrinking in value over time. By 1983, the excise tax rate would have increased from $6.30 to $18.16/bbl.

This method would have produced nearly 460 million dollars in additional revenues by 1983. In 1983 alone, Michigan could have brought in $121,106,181, compared to the $43,666,960 in actual beer revenues. This is a difference of more than 77 million dollars.

Figure 6 (6.cal/202)

MICHIGAN BEER EXCISE TAX RATE ADJUSTED FOR INFLATION: ESTIMATED REVENUE PROJECTIONS

YEAR	BARRELS SOLD	ACTUAL TAX RATE PER BARREL	BEER EXCISE TAX REVENUE	MICHIGAN CPI	ADJUSTED TAX RATE	ADJUSTED REVENUE	ANNUAL DIFFERENCE	CUMULATIVE DIFFERENCE
1967	5,832,648	$6.30	$36,855,161	100.0				
1968	5,855,414	$6.30	$36,741,982	104.3				
1969	5,829,861	$6.30	$37,315,892	110.6	$6.57	$38,110,676	$794,784	$794,784
1970	6,302,456	$6.30	$38,466,376	117.4	$6.97	$43,708,478	$5,242,102	$6,040,886
1971	6,310,608	$6.30	$39,547,160	121.7	$7.40	$46,465,007	$6,917,847	$12,958,733
1972	6,507,834	$6.30	$40,784,125	126.2	$7.67	$49,415,936	$8,631,811	$21,590,544
1973	6,443,063	$6.30	$40,702,070	134.5	$7.95	$50,710,127	$10,008,057	$31,598,601
1974	6,805,882	$6.30	$42,207,094	149.1	$8.47	$56,781,133	$14,574,039	$46,172,640
1975	7,019,820	$6.30	$44,473,106	160.3	$9.39	$64,927,368	$20,454,262	$66,626,902
1976	6,971,085	$6.30	$43,685,361	168.9	$10.10	$68,999,799	$25,314,438	$91,941,340
1977	7,431,961	$6.30	$46,198,769	180.4	$10.64	$77,494,544	$31,295,775	$123,237,115
1978	7,301,175	$6.30	$45,875,704	194.1	$11.37	$80,939,001	$35,063,297	$158,300,412
1979	7,012,142	$6.30	$43,962,254	218.8	$12.23	$83,614,534	$39,652,280	$197,952,692
1980	7,005,853	$6.30	$43,887,440	253.5	$13.78	$94,127,138	$50,239,698	$248,192,390
1981	6,968,258	$6.30	$44,012,367	277.1	$15.97	$107,944,588	$63,932,221	$312,124,611
1982	6,849,518	$6.30	$44,709,253	288.3	$17.46	$114,808,881	$70,099,628	$382,224,239
1983	6,946,711	$6.30	$43,666,960	296.5	$18.16	$121,106,181	$77,439,221	$459,663,460

EQUALIZATION: BEER TAX ADJUSTMENT BASED ON ETHANOL EQUIVALENCE WITH SPIRITS

Historically, it was believed that distilled spirits were a harder and more unhealthy form of alcohol than the beer and wine. This is one reason why federal and state taxes on beer and wine have been much lower than spirits taxes, and why spirits products have been more heavily regulated. From a public health and safety viewpoint, there is no basis for this unequal policy. Drink for drink, beer, wine, and spirits contain a similar amount of ethanol, about one half ounce each in 12 ounces of beer, 5 ounces of wine, and one ounce of spirits. It makes no difference to the human brain, liver, or other organs affected by alcohol whether the ethanol which impairs its functioning comes in the form of distilled spirits, beer, or wine. For the vital organs, a drink is a drink is a drink. Taste tests are irrelevant. Consequently, many scientists have argued that Federal and State government tax rates should be adjusted for ethanol equivalency. The distilled spirits industry has made the same argument.(11)

There appears to be no scientific evidence to suggest what the tax rate per unit of ethanol should be, from a public health vantage point. It is proposed here that beer tax rates be increased to the point of equalization with distilled spirits taxes. It would be contrary to the principles of sound public health policy to lower the current taxes on spirits to a point of equalization with beer.

Different beer and distilled spirits products contain different amounts of ethanol. To determine state tax rate per gallon of ethanol, we used national averages for the ethanol content of beer and spirits products. For 1983, the National Institute on Alcohol Abuse and Alcoholism estimates that average ethanol content for beer was 4.3% (8.6 proof) and for spirits, 41% (82 proof).

In each barrel of beer, there are 1.33 gallons of ethanol (.043 x 31 gallons). At a tax rate of $6.30/bbl, this amounts to 3.7 cents per ounce, or $4.74 per gallon of ethanol ($6.30 / 1.33).

Michigan taxes on spirits products are a percentage of the State's purchase price: a 51% mark-up on the purchase price, plus three specific taxes totaling 9.85% on the purchase price plus mark-up. Assuming a $3.00 State purchase price on a 25.4 ounce bottle (750 ml, or what used to be called a fifth), mark-up and specific taxes would amount to $1.97. Less the discount to licensees, this amount is reduced to

$1.20. This bottle would contain 10.41 ounces of ethanol (.41 x 25.4). This amounts to 11.5 cents per ounce of ethanol, or $14.72 per gallon of ethanol.(12)

If the tax on a gallon of ethanol for beer were to be increased to achieve parity (from $4.74 to $14.72), the excise tax per barrel would have to be increased by a factor of 3.11, from $6.30 to $19.59. The effect of this action would be to increase the excise tax on a six-pack from the current level of 11.4 cents to 35.5 cents, an increase of 24.1 cents per six-pack. Had this increase been put into effect in 1983, the State would have realized an increase of over 86 million dollars, even with a decrease in beer consumption as a result of the price increase.

Figure 7 compares ethanol-equivalency factors for spirits, beer, and light wine. Wine data are included here to show how the wine ethanol tax level compares to spirits and beer.(13)

IMPACT ON TAXES AND PRICES AT THE RETAIL LEVEL

The three tax policy alternatives presented above would clearly have significant effects over time on per barrel tax rates and state revenues. These large-scale, statewide effects would on balance be beneficial to the people of Michigan. Moreover, these benefits would not be offset by the imposition of major cost burdens on the individual consumer. This point can be

Figure 7

THE IMPACT ON 1983 REVENUES WHEN THE TAX RATES FOR ALL ALCOHOL PRODUCTS ARE EQUIVALENT

	Spirits	Beer	Light Wine
Average ethanol content	41%	4.3%	12%
Current tax per gallon of ethanol	$14.72	$4.74	$3.97
Impact of equivalence on tax rates	No change	Increase: $6.30/bbl to $19.59/bbl	Increase: 13.5 cents/liter to 50 cents/liter
Impact of tax rate equivalence on retail prices	No change	Increase: 11.4 cents to 35.5 cents per six-pack: a 24.1 cents increase	Increase: 13.5 cents/liter to 50 cents/liter: a 36.5 cents increase
Impact of tax rate equivalence on 1983 State tax revenues	No change	Increase: $43,666,960 to $129,962,195	Increase: $7,749,100 to $27,889,306

illustrated by examining the impact of the three policy alternatives on retail level taxes and prices.

On the large scale, a price indexation policy would have had the greatest impact. This policy would have generated a per-barrel tax increase of about $12.00 between 1982 and 1983 (from $43.78 to $55.91), and a revenue increase of around 70 million dollars (Figure 5). At the retail level, the price of a six-pack would have risen by 10 cents, from $3.55 to $3.65. This price is in contrast to an actual retail price of $2.71 in 1983, an increase of 6 cents over 1982. Comparing annual consumer beer expenditures at the $2.71 vs. the $3.65 price levels, a person who bought one six-pack a week would have paid an additional $48.88 for the year. A person who consumed one six-pack every day (a very unhealthy level of alcohol consumption, associated with probable long-term organ damage and possibly indicating alcohol dependence) would have expended an additional $343.10 over the course of the year. While this is a fair amount of money, it would have taken 15 years of price adjustments to reach this magnitude.

A tax indexation policy would have led to an increase in the beer tax rate of $0.70 from 1982 to 1983, and a revenue increase of more than 6 million dollars (Figure 6). At the retail level, the per barrel tax increase would involve a one cent increase in the price of a six-pack (the tax rate per six-pack would increase from 31.7 cents to 32.9 cents). Even those consumers who purchase very large quantities of beer would be virtually unaffected by the tax and price increase.

A policy calling for tax equivalence based on ethanol content, implemented in a single step in 1983, would have raised the tax rate from $6.30 to $19.59 per barrel. Tax revenues would have risen by over 86 million dollars. For the consumer, this would have meant an increase of about 24 cents per six-pack, as the tax rate per six-pack would have increased from 11.4 cents to 35.5 cents. A person who bought one six-pack a week would have paid out about $12.50 a year in additional beer expenses. An individual who consumed one six-pack every day would have expended an additional $88.00 for the year.

PROJECTED FUTURE REVENUES: 1986-1988

The previous discussion has examined the historical effects of Michigan public policies on beer pricing and taxation. These policies have led to declining retail prices of beer, and to considerable losses of State revenues. These policies have also contributed to increasing levels of alcohol-related health and safety damage. Put together, these effects have created an imbalance between the benefits and costs of alcohol to the people of Michigan. Three methods for rectifying this imbalance were suggested: beer price indexation, tax indexation, and ethanol equalization. Had any one of these policies been implemented in the past, revenue losses could have been avoided, and public health and public safety benefits could have been realized. This holds true for the future as well. Using projected annual CPI and beer sales volume estimates, the implications of adopting each of these policies in 1985 are discussed below.(14)

1. Price indexation

Indexing the price of beer involves adjusting retail prices according to the CPI. This policy causes beer prices to keep pace with other consumer goods and services, to prevent beer from becoming cheaper over time. This policy has the largest impact on prices and revenues.

If price indexation were to be implemented this year, in 1986 the price of a six-pack of domestic beer would rise to about $2.98, through a tax rate of $13.45/bbl. This rate would generate over 84 million dollars in revenue for the year, even if beer sales continue to decrease with the national trend, and if the price increase caused sales to decrease even further. In 1987, the price of a six-pack would become $3.14, with a $22.27 tax per barrel. More than 136 million dollars in revenues would be generated. And by 1988, the price would rise to $3.32 per six-pack, the tax to $32.19, and the revenues to just over 192 million dollars. These revenue figures compare favorably to projected actual revenues of between 38-41 million dollars a year for 1986-1988.

2. Tax indexation

Indexing the beer excise tax to the CPI prevents erosion of revenues due to inflation. This approach would have a smaller impact on beer prices, taxes, and revenues than price indexing, but revenue benefits are still significant.

If tax indexation were implemented, 1986 six-pack prices would increase about one cent, from $2.85 to $2.86. The beer excise tax would become $6.58, and revenues would be more than 42 million dollars, compared to under 41 million dollars in projected actual 1986 revenues. By 1988, the price of a six-pack would increase to only about $2.88, the excise tax to $7.32, and revenues to nearly 45 million dollars. Over the three-year period (1986-1988), approximately 11.5 million dollars in additional revenues would be gained.

3. Tax equalization per ethanol content

Equalization presents the advantage of taxing alcoholic products according to their ethanol (absolute alcohol) content. The current Michigan alcohol tax system is based on the historical misconception that distilled spirits are inherrently more unhealthy than beer. All alcoholic beverages should be taxed on a consistent basis, according to their ethanol content. As noted earlier, equalization would raise the beer excise tax from $6.30/bbl to $19.59/bbl, and the price of a six-pack by about 25 cents.

From 1986 through 1988, equalization would generate nearly 365 million dollars in excise tax revenues. Michigan's current tax system would generate about 120 million dollars.

IMPACT ON CONSUMERS

There is no question that the State General Fund, and thus the citizens of Michigan, have much to gain by increasing the excise tax on beer: significant revenue increases (or at least a countering of the long-term trend of income loss), and a more favorable balance between alcohol-related damage and benefit (at minimum, reducing the growing gap between costs and income). However, this does not mean there aren't arguments against a tax increase. One traditional argument against alcohol tax increases is that alcohol tax increases would place an unfair, unpopular, and heavy burden on consumers. Upon reflection, this is not a strong argument.

First, if a program of tax increases were such as to prevent relative retail prices from steadily declining, there would be a moderating effect on alcohol consumption across the population as a whole. This alone would help reduce alcohol-related damage to individuals, families, communities, and the overall economy. Directly and indirectly, the population as a whole would benefit.

Most Michigan citizens would favor an alcohol price increase. In a 1984 scientific survey of alcohol-using adults in Michigan, more than two-thirds of the respondents said they would be willing to pay 10-20% more for alcohol products if the higher price would help to reduce population-wide alcohol problems.(15) This seems to indicate that, as a group, Michigan's alcohol users are aware of the serious and costly nature of alcohol problems, and are willing to make individual contributions toward alleviating these problems. Had the survey included non-drinkers as well (comprising one of three Michigan adults), it is certain that the level of support for price increases would have been much greater than even the high level of support revealed.

Second, most Michigan citizens would be affected very little by an increase in beer taxes. This is because relatively few people drink so much that a price increase would require appreciable increases in expenditures for alcohol. According to the National Institute on Alcohol Abuse and Alcoholism, 35% of adults do not use alcohol. Thirty-two percent of adults are classified as light drinkers, who have from one drink a year up to three drinks a week. That is, for two out of three adults (67%), alcohol consumption is not a large part of their lifestyles, or does not figure at all in their lifestyles. About 22% of adults are classified as moderate drinkers, people who consume an average of from 4-13 drinks per week. And 11% are considered heavier drinkers, consuming 14 or more drinks in an average week.(16) It should be emphasized that the term moderate is not appropriate for the person who consumes up to 13 drinks on one or two occasions, even though his or her weekly total is less than 13. Consumption to the point where one's mental and physical abilities are impaired is not moderate drinking.

Alcohol-related damage arises from the short-term actions of people who are intoxicated, and from the long-term affects of unhealthy levels of consumption (more than two drinks a day). Most of this damage is caused by the drinking patterns of only one-third of the adult population, the people who occasionally or regularly over-consume. But the costs are spread across the entire population. Alcohol excise tax increases would have greater impact on those whose consumption levels tend to cause harm to themselves and to others. This appears to be fair, in that the public expenditures on alcohol-related damage are allocated largely to those who tend to use more alcohol.

Figures 8 and 9 show how much money the four levels of drinkers would spend weekly and yearly at current tax levels and at selected higher tax levels.(17) Figure 8 indicates total beer expenditures at three prices for a take-out six-pack of domestic premium beer at 1983 prices, including sales tax. If purchases were on a 12-pack or case basis, or if less expensive brands were purchased, expenditures would be lower; if beer were purchased for on-premises consumption, expenditures would be greater.

In Figure 8, it can be seen that weekly and annual beer expenditures for the vast majority of consumers would increase only slightly at a price increase of 23 cents per six-pack (from $2.82 to $3.05). These minor increases in expenditures diminish further in view of a projected revenue increase of over 80 million dollars (even if consumption and sales dropped somewhat due to

(8.cal/202)

Figure 8

IMPACT ON CONSUMERS IF BEER TAXES AND PRICES WERE RAISED: ANNUAL BEER EXPENDITURES UNDER CURRENT AND PROPOSED TAX POLICIES

Type of Drinker and % of Adult Population

Beer Tax Policy	Abstainers (35%)	Light (32%)	Moderate (22%)	Heavy (11%)	General Fund Revenues
Status quo	0	up to $73.32	$97.76 to $317.72	$342.16 or more	$43,666,960
Tax Indexation (Adjust tax rate to CPI)	0	up to $79.25	$105.66 to $343.41	$369.82 or more	up to $121,106,181
Price Indexation (Adjust prices to CPI)	0	up to $98.80	$131.66 to $427.91	$460.82 or more	up to $320,442,255

Estimated annual expenditures and revenues are based on the 1983 sales volume, and prices per six-pack, including sales tax, as follows: status quo, $2.82; tax indexation, $3.05; and price indexation, $3.80. Per barrel tax rates under the three tax policies are $6.30, $18.16, and $55.91, respectively. Impact of an ethanol tax equalization policy is not shown above. Under this policy, the price of a six-pack would become $3.07, tax included, and thus would have an impact on expenditures and revenues similar to tax indexation.

(9.cal/202)

Figure 9

ANNUAL CONSUMER TAX EXPENDITURES AND STATE REVENUES AT SELECTED BEER EXCISE TAX LEVELS

	Type of Drinker and % of Adult Population				
Beer Excise Tax Level	Abstainers (35%)	Light (32%)	Moderate (22%)	Heavy (11%)	General Fund Revenues
$6.30/bbl	0	up to $2.96	$3.95 to $12.84	$13.83 or more	$43,666,960
$10.00/bbl	0	up to $4.68	$6.24 to $20.28	$21.84 or more	up to $68,598,770
$15.00/bbl	0	up to $7.02	$9.36 to $30.42	$32.76 or more	up to $101,178,846
$25.00/bbl	0	up to $11.86	$15.81 to $51.38	$55.33 or more	up to $162,813,539

Six-pack prices at each of the four excise tax levels, not including sales tax, are $2.71, $2.78, $2.87, and $3.05, respectively. The expenditures shown represent the amount of beer excise tax each type of drinker would pay on a yearly basis at each excise tax level.

the price increase, revenues would still go up significantly). People who consumed two drinks a day--the maximum amount a healthy adult can consume without incurring health risks--would spend only an additional $27.66 in an entire year. At a $.98 price increase (up to $3.80/six-pack), expenditures increase more sharply.

Figure 9 shows expenditures in terms of State beer excise tax amounts at four levels of tax. Again, most drinkers pay relatively small amounts currently, and these amounts would slightly increase with successive hypothetical tax increases.

SUMMARY

The central argument of this paper is that the steady decline in the relative price of beer in Michigan has resulted in two significant losses. First, lower prices have made beer more economically available, and have therefore helped to stimulate excessive alcohol consumption. Excessive consumption leads to a wide array of serious health problems, social disruption, injuries, fatalities, lost work production, and economic loss. Second, because beer has been taxed at the same flat rate since 1966, the State has lost hundreds of millions of dollars in revenues over this period, as inflation has cut dramatically into the value of tax dollars earned. A public policy which has allowed this substantial revenue loss becomes even more suspect in light of the fact that the economic costs of alcohol problems have increased over time, creating an increasing imbalance between the harms and benefits of alcohol consumption in Michigan.

In a large context, Michigan's array of alcohol policies have worked at cross purposes. On the one hand, there has been a tax policy that provides an inducement (cheaper prices) for people to consume more alcohol. On the other hand, the State has invested in educational and law enforcement programs aimed at persuading people to avoid over-use of alcohol. Because American culture in general has tended to encourage alcohol use, and because of the powerful nature of alcohol as a drug, programs which appeal to people's reason and responsibility are confronted with a very difficult challenge. It is only sensible to lessen any artificial and unnecessary inducements to consume alcohol.

Three remedies are proposed: price indexing, tax indexing, and ethanol tax equalization. Each of these proposals has its particular advantages. Although their impact would differ by degrees, each would help reduce the influence of low beer prices on excessive alcohol consumption. Each would generate hundreds of millions of dollars in additional revenues, which could be used to further reduce the scope and severity of community and individual problems arising from excessive alcohol consumption. Each proposal would contribute to a more humane, more rational, and more fiscally sound public policy on alcohol in Michigan.

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NOTES

1. Numerous discussions of the relationship between alcohol prices, alcohol consumption levels, and alcohol-related problems have appeared in print. For example:

    a. P. J. Cook, "The Effects of Liquor Taxes on Drinking, Cirrhosis, and Auto Accidents," in M. H. Moore and D. L. Gerstein (Eds), Alcohol and Public Policy: Beyond the Shadow of Prohibition. National Academy Press, 1981.

    b. B. Rush, M. Steinberg, and R. Brook, "The Relationships Among Alcohol Availability, Alcohol Consumption, and Alcohol-Related Health Damage in the Province of Ontario and the State of Michigan, 1955-1982," presented at the annual meeting of the National Council on Alcoholism, Detroit, MI, 1984.

    c. I. Colon and H.S.G. Cutler, "The Relationship of Beer Consumption and State Alcohol and Motor Vehicle Policies to Fatal Accidents," Journal of Safety Research, 14, 1983, pp. 83-89.

2. Traditionally in North America, people have tried to prevent alcohol problems through education and information programs, and through periodic intensification of law enforcement efforts. These approaches focus on individual consumers, attempting to dissuade them from excessive or inappropriate drinking. More recently, considerable scientific and public attention has been devoted to investigations of how legal, economic, marketplace, and social environments have contributed to alcohol-related damage. Numerous of these investigations have concluded that these environments have over the past several decades become more and more unhealthy, in

that they have increasingly tended to encourage alcohol use. A climate that encourages the use of alcohol inevitably encourages abuse, given the large number of people who are, or who learn to be, vulnerable to chronic and periodic overdrinking.

Among the many references available on this topic are the following:

a. A. Luks. Will America Sober Up? Beacon Press, Boston, 1983.

b. L. J. West, editor. Alcoholism & Related Problems: Issues for the American Public. Prentice-Hall, Englewood Cliffs, New Jersey, 1984.

c. M. H. Moore and D. R. Gerstein, editors. Alcohol & Public Policy: Beyond the Shadow of Prohibition. National Academy Press. Washington, D.C., 1982.

d. R. Brook and M. Steinberg. Healthy People in Healthy Environments: A Public Health Approach to Preventing Alcohol Problems, presented at the 11th Winter Midwest Institute on Alcohol Studies, January 6-11, 1985, Kalamazoo, MI.

3. NIAAA estimates that the average ethanol content of beer is 4.3% (8.6 proof). Distilled spirits: 41%(82 proof). Light wine: 12% (24 proof). Sales figures are from the Michigan Liquor Control Commission's 1983 Annual Financial Report, page 2. Ethanol consumption is derived by multiplying average ethanol content by quantity sold. Wines over 16% ethanol content are not included in the table or elsewhere in this paper because of the small amount sold and consumed. FY 82/83 sales were only 139,263 gallons.

4. Michigan alcohol tax rates are set by the Legislature, and referenced in the Liquor Control Act. The beer excise tax is referenced in section 436.40(1). The wine taxes are at 13.5 cents per liter for wines containing 16% alcohol or less, and 20 cents per liter for wines over 16% alcohol. Michigan-produced wines are taxed at one cent per liter. These rates have held since 1937, though there was a conversion to the metric system (gallons to liters) in 1982 (Sec. 436.16a(1)-(3)).

Wine tax revenues are deposited in the General Fund.

Spirits taxes include the State mark-up of 51% on the State's purchase price (Sec. 436.16(1)), which was last revised in 1980 with an increase from 48%. Three specific taxes are applied to the purchase price plus mark-up. One is a 4% tax imposed in 1957, with revenues deposited in the School Aid Fund (Sec. 436.101). A second 4% tax took effect in 1960, applied to the General Fund (Sec. 436.121). A 1% tax applying only to off-premise sales was added in 1973, and increased to 1.85% in 1978, with proceeds deposited in the Liquor Purchase Revolving Fund (Sec.436.131).

Retail licensees receive a 17% discount on their purchases from the State (Sec. 436.16(3)). For off-premises licensees, this discount constitutes the gross profit margin, since take-out prices are set by the State (the MLCC) and may not be raised or lowered. On-premises licensees receive the same discount, but may charge whatever they wish for drinks, so long as the price is not less than what they paid for the alcohol.

5. Data on barrels sold and beer excise tax revenues are from the Liquor Control Commission's 1983 "Statistical Look." Michigan CPI and disposable income data are from the Michigan Department of Management and Budget. Data on tax revenues (in 1967 dollars) were computed by dividing each year's revenues by that year's CPI. Beer CPI data are from R. Solander and P. Kakela, "Effects of Michigan's Mandatory Beverage Container Deposit Law," Department of Resource Development, Michigan State University, East Lansing, Michigan. Annual six-pack prices are estimated based on the beer CPI, and do not include sales tax and bottle deposit. The price estimates assume that a six-pack of premium domestic beer (e.g., Stroh's, Budweiser) cost $2.71 in 1983. Prices for other years were then computed from the beer CPI.

   It should be noted that sales and revenue figures in the first two columns are inconsistent for some of the years, in that barrels sold multiplied by the $6.30 tax does not equal the tax revenue figure. For example,the 1983 sales of 6,964,711 barrels would equal $43,764,279 when multiplied by $6.30, not the $43,666,960 shown. Nevertheless, these are the figures published by the MLCC.

Discrepancies may be due to calculations being made on a calendar year vs. fiscal year basis, to rebates for lost or broken products, or to accounting variations.

6. M. Steinberg, J. Pearson, and J. Nischan, "Inventory & Analysis of Public Policy on Alcohol in the State of Michigan." Presented at the National Council on Alcohol's National Alcoholism Forum, Detroit, Michigan, April 12-15, 1984.

7. California Health Research Foundation. "Economic Costs to the State of Michigan for Alcohol & Drug Abuse & Mental Illness--1982." Report submitted to the Michigan Office of Substance Abuse Services, 1983. This report contains what the author regards as conservative estimates of the costs of alcohol-related problems. Cost factors included early death, illness, lost work production, treatment and rehabilitation, law enforcement, and others.

8. J.F. Mosher, "Tax-Deductable Alcohol: An Issue of Public Health Policy and Prevention Policy." Journal of Health Politics, Policy, and Law, Vol. 7, No. 4, Winter 1983, pp. 854-888.

9. In addition to the sources given in notes 1 and 2 above, see also:

   a. R.Room, "Alcohol Control and Public Health." Annual Review Public Health, 1984, 5:293-317.

   b. B.Rush, L.Gliksman, and R.Brook, "Alcohol Availability, Alcohol Consumption and Alcohol-related Damage. Part I: The Distribution of Consumption Model." Submitted to the Journal of Studies on Alcohol, 1985.

   c. D.Levy and N.Sheflin, "New Evidence on Controlling Alcohol Use Through Price." Journal of Studies on Alcohol, pp. 929-937.

   d. J.F.Mosher and D.E.Beauchamp, "Justifying Alcohol Taxes to Public Officials." Journal of Public Health Policy, December 1983, pp 422-439.

e. S.I.Ornstein, "Control of Alcohol Consumption Through Price Increases." Journal of Studies on Alcohol, Vol. 41, No. 9, 1980, pp 807-818.

f. B.C.McCornac and R.W.Filante, "The Demand for Distilled Spirits: An Empirical Investigation." Journal of Studies on Alcohol, Vol. 45, No. 2, 1984, pp 176-178.

g. B.Rush, M.Steinberg, R.Brook, "The Relationship Among Alcohol Availability, Alcohol Consumption and Alcohol-Related Damage in the Province of Ontario and the State of Michigan." Advances in Alcohol and Substance Abuse, in press.

Nearly all those who have carefully investigated the relationships between alcohol taxes, revenues, prices, and consumption have concluded that appropriate tax increases will both increase revenues and will result in some decreases in consumption. Of course, cautions are in order. Retail price increases should not be so sudden or so large as to encourage large-scale bootlegging or other illegal activities. Also, while a decline in per capita consumption would yield important public health and public safety benefits, this does not mean that Michigan's alcohol-related problems would be solved. It would mean that an efficient, effective, and necessary step had been undertaken toward reducing alcohol problems as far as is feasible.

10. B. Weinstein, "The Michigan Liquor Control Commission and the Taxation of Alcoholic Beverages," in H. Brazer (ed), Michigan Fiscal and Economic Structure 1982, University of Michigan, Ann Arbor, Chapter 23.

In Figure 5, revenue adjustments for price elasticity of demand were made on an annual basis by computing the percentage price increase per six-pack, then reducing annual sales by one half of this percentage, then multiplying the reduced sales figure by the adjusted annual excise tax. The same method is used in the remainder of the paper. Adjustments in annual sales volumes were made independently for each year, with no accumulation of downward adjustments over time. This is to avoid confounding the effects of natural market and consumer influences that were in effect during the period of analysis.

It is possible that the price elasticity estimate used here would become invalid on a longer term basis, as beer prices continued to rise over time. If in actual experience this were discovered to be the case, then policy revisions could easily be made.

11. See, for example, Moore and Gerstein, op.cit, pp. 71-72; the National Council on Alcoholism's "Prevention Position Statement" (NCA, Inc., 733 Third Avenue, New York, N.Y., 10017); and the Distilled Spirits Council of the United States' "Facts Book," various years.

12. The Federal tax on spirits is based on ethanol content. The rate is $10.50 per proof gallon, or $10.50 for one gallon of 100-proof spirits. Products with lower ethanol content are taxed less. One gallon of 80-proof spirits is taxed at .80 x $10.50, or $8.40.

Michigan's taxes on spirits are a function of how much the State paid for a bottle. Except for the fact that the Federal tax is a component of the State's purchase price, Michigan spirits taxes are independent of ethanol content. Calculation of a Michigan spirits tax "per gallon of ethanol" is therefore somewhat arbitrary, since tax amounts vary with the price of a bottle.

In our calculations, we selcted a bottle with a State purchase price of $3.00. The retail take-out price of this bottle, including sales tax, would be $5.17 (this includes 77 cents gross profit to the retailer). We believe this is a moderately priced bottle, and therefore a reasonable one for use in our illustration of the ethanol tax difference between spirits and beer.

Had our calculations been based on a bottle with a State purchase price of $2.00 ($3.45 retail), we would have arrived at an ethanol-equivalent beer tax of $13.10 per barrel. Basing the equivalence on a bottle costing the state $4.00 ($6.90 retail), the beer tax would correlate at $26.21 per barrel, compared to the $19.59 per barrel equivalent tax suggested in our illustration of the $3.00 bottle.

It might be added that Federal taxes on spirits, beer, and wine, like Michigan's, are not equivalent with respect to ethanol content.

Federal taxes on domestic products have been constant since 1951. These taxes, and their ethanol conversions, are as follows:

Spirits:	$10.50 per proof gallon, or $21.00 per gallon of ethanol.
Beer:	$9.00/bbl, or $6.77 per gallon of ethanol.
Wine:	(14% still wines): $0.17/gallon, or $1.15 per gallon of ethanol.

13. The adjusted wine revenues take into account a likely sales decrease following the price increase. For wine, the estimated price elasticity of demand used here is -.23, i.e., a 10% price increase would result in a 2.3% drop in sales (see Weinstein, op.cit.). As with beer, this level of drop in sales still results in a sizeable increase in revenues.

14. Michigan future CPI estimates are from the Chase Econometric Regional Forecasting Service, computed in Fall, 1984. Projected annual CPIs are:

1985 - 321.4

1986 - 338.1

1987 - 357.6

1988 - 377.0

Beer sales data are projected from FY 1983-84 sales figures contained in the 1984 Annual Report of the MLCC. Between FY 1982-83 and FY 1983-84, there was a 2.4% sales decline. Projected annual actual sales figures are based on reducing each year's volume by 2.4% through 1988, to reflect the fact that State and national beer sales are in a period of decline.

Beer retail prices are estimated at $2.85/six-pack currently. The effect of price increases on demand is calculated at the 10%/5% ratio through 1988 using $2.85 as a starting price. Revenue projections from price and tax indexation and from equalization take price elasticity of demand into account.

All other calculations are as done in the section on historical adjustments.

15. National Institute on Alcohol Abuse and Alcoholism. "The Public Health Approach to Problems Associated with Alcohol Consumption: A Briefing." Chart I-7. 1980.

16. C. Atkin. "Statewide Survey of Alcohol Attitudes, in Impact of Alcohol on the People of Michigan. Volume 2. Michigan Office of Substance Abuse Services and the Michigan Department of Highway and Safety Planning.

17. Calculations for Figure 8 are as follows. The $2.82 six-pack price was created by adding 4% sales tax to the $2.71 actual estimated price for 1983 from Figure 2. The $3.05 six-pack price was derived from figure 6 data, by adding 21.5 cents (the difference between current and 1983 projected tax levels per six-pack) to the $2.71 estimated actual price, then adding the 4% sales tax. The $3.80 six-pack price is computed by adding sales tax to the $3.65 projected price for 1983 in figure 5. Expenditure estimates were computed by dividing the six-pack prices by 6, then multiplying the unrounded per-beer price by the number of beers each type of drinker consumes annually. Annual consumption per type of drinker is obtained by multiplying by 52 the weekly consumption levels given on page 26. Revenues estimates are from Figures 5 and 6.

    Figure 9 estimated expenditures were derived by dividing tax rates by 55.12 (the number of six-packs per barrel), then by 6 to arrive at a per-beer tax rate, then proceeding as above.

Office of Special Adviser to the President
for Consumer Affairs
Washington, D.C. 20201

September 28, 1987

Honorable Howard M. Metzenbaum
Chairman
Subcommittee on Antitrust, Monopolies
and Business Rights
Committee on the Judiciary
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We want to thank you for the opportunity to respond to your recent request for the views of the Office of the Special Adviser to the President for Consumer Affairs on S. 567, the Malt Beverage Interbrand Competition Act. We oppose this legislation for the reasons discussed below.

S. 567 would grant antitrust immunity to agreements between brewers and distributors that establish exclusive distribution territories. Under such an agreement, a beer manufacturer grants a franchised distributor the exclusive sales rights for a particular brand in a given geographic area. The bill would sanction the antitrust immunity for exclusive distributorships as long as there is still "substantial and effective" interbrand competition.

In effect, S. 567 would grant the malt beverage industry special status under the antitrust laws. Currently, exclusive distribution agreements, also known as non-price vertical restraints, are examined under an antitrust rule of reason. Under the rule of reason, an exclusive distribution agreement is deemed lawful as long as its adverse effects do not outweigh its competitive benefits.

We opposed similar legislation introduced during the 99th Congress (S. 412) and oppose the current legislation, S. 567, because we believe that special antitrust immunity for beer wholesalers would not result in any corresponding improvement in product or service and could lead to higher prices for consumers. We have noted that exclusive beer distributorships are legal as long as they are not anti-competitive. Thus, consumers already benefit, and will continue to benefit, from those agreements that achieve more efficient and desirable distribution of goods and services. Nothing would be gained by making all exclusive distribution arrangements immune from the antitrust laws. This might allow some anti-competitive agreements to escape antitrust scrutiny, which would lead to higher prices for consumers.

Moreover, S. 567 would put beer wholesalers in a privileged position not available to wholesalers of other products. It might invite attempts by producers of other commodities to get similar antitrust immunity. This would not be in the best interest of consumers or a competitive marketplace.

In conclusion, the Office of the Special Adviser to the President for Consumer Affairs opposes passage of S. 567 because it would not result in any corresponding improvement in product or service and because it would increase the risk that some anti-competitive arrangements might go unchallenged, leading to higher prices for consumers.

The Office of Management and Budget advises that there is no objection to the presentation of these views from the standpoint of the Administration's program.

Sincerely,

Virginia Knauer

Virginia H. Knauer
Special Adviser to the President
for Consumer Affairs

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September 28, 1987

The Honorable Dennis DeConcini
Committee on the Judiciary
United States Senate
Washington, D.C. 20510-6275

Dear Senator DeConcini:

Re: Additional Comments on S. 567

As requested by Matthew J. McCoy's letter of September 22, 1987, I have reviewed the additional materials submitted by New York State Attorney General Robert Abrams concerning S. 567, the Malt Beverage Interbrand Competition Act, and submit the following comments which I hope will be of assistance to you and the Committee.

The first issue raised by Attorney General Abrams' letter concerns recent litigation involving the Soft Drink Interbrand Competition Act on which S. 567 is modeled. As is evident from a review of the Commonwealth of Pennsylvania v. Pepsico, Inc. decision (which has been included in the record of this proceeding), the legal standard established by the Soft Drink Interbrand Competition Act provides a quick and effective method of disposing of frivolous challenges to the use of exclusive territories. Contrary to the repeated assertions of Attorney General Abrams and other opponents of the legislation, courts have had no difficulty in understanding or applying this standard.

Nor, as Mr. Abrams appears to suggest, is there any confusion concerning the standard's applicability to horizontal conduct. Both the Soft Drink Act and S. 567 make clear that horizontal conspiracies in restraint of trade are not immunized and are subject to the full force of the antitrust laws. But liability for horizontal conduct does not extend, as Pennsylvania Attorney Zimmerman unsuccessfully tried to establish in the Pepsico case, to conduct necessary to protect the validity of lawful, vertically-imposed exclusive territories. As the court in Pepsico recognized:

> The complaint alleges nothing more than a classic vertical restraint which is protected by the specific provisions of the Act, and we do not believe that we are required to allow this case to proceed on the facts alleged. Commonwealth of Pennsylvania v Pepsico, 658 F. Supp. 816, 823-24 (M.D. Pa. 1987), appeal filed, No. 87-535 (3d Cir. 1987).

In reading this conclusion, the court did not commit "clear error which will undoubtedly be reversed on appeal." Rather, its analysis reflects a large number of previous decisions recognizing that efforts to enforce exclusive territories (such as bans on transhipping) do not violate the antitrust laws. See, e.g., Sports Center, Inc. v. Riddell, Inc., 673 F.2d 786, 791-92 (5th Cir. 1982) (ban on sales to resellers or transhippers "is not equivalent to conspiracy").

On the other hand, I am somewhat puzzled by Mr. Abrams' request to include in the record a copy of the opinion in State of Texas v. Coca-Cola Bottling Company of the Southwest, 697 S.W.2d 677 (Tex. App. 4th Dist. 1985), as support for the argument that passage of the Soft Drink Act has introduced confusion into the law. This opinion, which involves a merger challenge not an examination of vertical restraints, reversed a lower court decision that the Texas statute merger statute was unconstitutional on supremacy and commerce clause grounds. In so doing, the Texas appellate court considered the preemptive effect of the federal merger statute, Section 7 of the Clayton Act, and of the Soft Drink Act. It concluded that because there was no repugnancy between these federal laws and the state merger statute, the latter was not preempted. (Indeed, this conclusion is required by the plain language of the Soft Drink Act, which expressly states Congressional intent not to preempt state laws.)

The Texas decision does not involve application of the substantive legal standard established by the Soft Drink Act, and the lower court would presumably have reached the same determination of unconstitutionality on the basis of the Clayton Act alone. Thus, I fail to see how this decision supports Mr. Abrams' claim that "the confusing language and vague standard of the Soft-Drink Act has engendered other such mistakes and subsequent reversals."

Mr. Abrams next asserts that S. 567 overrules the Supreme Court's decision in GTE Sylvania by eliminating consideration of anticompetitive intrabrand effects from the balancing process required in applying the rule of reason. Nothing could be further from the truth. The "substantial and effective competition" standard established by S. 567 provides a framework for implementing the generally unstructured balancing test required by the rule of reason analysis established in Sylvania.

Mr. Abrams' misguided focus on the nature of intrabrand competition ignores the uncontroverted fact that consumer welfare is determined by the overall level of competition in the market, not just the level of competition for the products of one manufacturer. In this regard, the use of exclusive territories is as competitively neutral as a manufacturer's decision to serve as the sole distributor for his products. While either distribution option eliminates intrabrand competition, the overall impact on consumer welfare can only be ascertained by considering the nature of interbrand competition in the market. Mr. Abrams' analysis completely ignores the increased level of interbrand competition that will likely result from the use of exclusive territories (since a distributor is thereby left free to focus his competitive energies on other manufacturers' products) and his assumption that the loss of intrabrand competition invariably leads to a decrease in interbrand competition simply cannot be supported.

The third issue raised by Mr. Abrams is the alleged relevance of retail price surveys as a measure of wholesale prices. His comments implicitly acknowledge the validity of reviewing wholesale prices in order to assess the impact of exclusive territories. Yet he fails to consider the best available evidence, namely, a comparison of wholesale prices in states with exclusive territories and those without such restrictions. In contrast to the detailed study of wholesale prices undertaken by the National Beer Wholesalers Association, Mr. Abrams appears content to rely on a consumer "market basket" survey of retail prices limited to selected outlets in New York City as probative evidence of the impact of exclusive territories. He now attempts to bolster this survey concerning alleged changes in beer prices with similar "evidence" concerning an alleged drop in retail milk prices as a result of additional wholesaler entry.

While it may be "self-evident" that there is a relationship between wholesale and retail prices, the precise nature of this relationship and an understanding of the various factors that influence retail price cannot be ascertained by a consideration of retail prices alone. For example, as discussed at the hearing, Dr. Tollison's study illustrated the important relationship between restrictions on price posting and other forms of advertising and beer prices. Moreover, any attempt to make analytical judgments based on retail price information becomes even more dangerous when that information is limited to such a narrow (and unique) "market" as a few, select retailers in New York City. In fact, it was this inability to rely on flawed data such as the New York retail price study that prompted the National Beer Wholesalers Association to undertake its comprehensive and analytically supportable price review.

While the flaws in the New York retail price study are many, two obvious points deserve emphasis. First, the alleged price increase in beer prices was not matched by soft drinks, even though soft drinks were also protected by exclusive territories during this period. The problem, if there in fact is any, must therefore lie elsewhere. Second, this suggests that beer retail prices were more directly affected by other factors during this period. The implementation of a "bottle bill" imposing a cost on all beer containers as well as brewer price increases during this period are more likely causes of any price rise. The New York Attorney General's argument is unfortunately a simplistic, and in this case erroneous, analysis. By examining only retail prices (assuming arguendo that his doubtful figures are half-accurate), he has drawn a false conclusion undeserving of any credibility.

The final point raised by Mr. Abrams concerns the so-called "Miller Memorandum" in which Miller and other brewers opposed enactment of exclusive territories legislation in New York state in 1976. Mr. Abrams takes issue with my statement at the August 4 hearing that this memorandum must be viewed in light of the per se standard then applicable to non-price vertical restraints such as exclusive territories. While the brewers themselves (particularly Miller) can provide the only definitive explanation for their change in position, it seems obvious that the radically changed legal standard resulting from the 1977 Sylvania decision undoubtedly played a major role in their decision. I do not agree with Mr. Abrams' suggestion that the brewers would not have been influenced by the pre-Sylvania per se illegality of vertical restraints such as exclusive territories because of the limited number of state statutes mandating the practice. In 1976, the law regarding state action immunity from antitrust liability was much more in flux than it is today; this fact, combined with the per se illegality of vertical practices, unquestionably contributed to the brewers' 1976 position.

Mr. Abrams' alternative explanation -- that "[t]he brewers have now obviously caved in to the pressure exerted by beer wholesalers on a collective basis" -- is a flattering but unsupportable basis for the brewers' change of position. The suggestion that small, local businessmen, even assuming their collective action, could dictate the distribution policies of national corporations of the size and with the financial resources of Miller and Anheuser-Busch is fanciful. Again, there is neither credible evidence nor a plausible theory to support these assertions.

I hope these comments are helpful to you and the Committee. If I can be of any further assistance, please do not hesitate to contact me.

Sincerely,

Ernest Gellhorn

Ernest Gellhorn

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October 7, 1987

Chairman Howard Metzenbaum
Subcommittee on Antitrust, Monopolies,
  and Business Rights
Committee on the Judiciary
U.S. Senate
Washington, DC 20510

Dear Chairman Metzenbaum:

Re: The Malt Beverage Intrabrand Competition Act (S.567)

I recently had an opportunity to review some of the testimony and exhibits which were presented to the Subcommittee on August 4, 1987 in support of S.567: The Malt Beverage Intrabrand Competition Act. In reviewing this testimony I noticed that several aspects of the beer industry, especially those related to the state of Indiana, were misrepresented in the testimony. The purpose of this letter is to provide some clarification on these issues:

1. Approximately four years ago (November 3, 1983) I testified before the Subcommittee on Monopolies and Commercial Law of the Committee of the Judiciary of the U.S. House of Representatives concerning an earlier version (H.R. 2262) of the Malt Beverage Intrabrand Competition Act. In that presentation and in a subsequent study that was published earlier this year in The Antitrust Bulletin (Volume XXXII, No. 1, Spring 1987), I discussed the history, current status, and economic impact of exclusive territories in Indiana. My findings indicated that the elimination of exclusive territories in Indiana led to a decrease in retail and wholesale beer prices of approximately 8 to 10 percent. These findings were based on extensive surveys of both wholesale and retail prices and included information about actual prices paid by both retailers and consumers. The majority of Indiana consumers and legislators continue to be strong supporters of their state's Alcoholic Beverage Commission Rule 28 which prohibits exclusive territories in the distribution for beer.

2. Because of the many factors affecting demand and supply, it is difficult to make meaningful interstate comparisons of beer prices. Breweries are not located uniformly throughout the country and thus there are significant transportation cost differences to alternative locations. Breweries also follow different marketing and pricing

strategies in various markets. Instead, it is better to examine the impact of exclusive territories directly by analyzing the effect of the imposition of such restrictions in a specific market, as we have done in our analysis.

Prices in Indiana may or may not be higher than the national average. This point is irrelevant, however, as far as the proposed Malt Beverage Intrabrand Competition Act is concerned. The key question is whether or not prices in Indiana are now lower than they would be had exclusive territories been allowed. The evidence clearly indicates that prices in Indiana are lower and intrabrand competition keener because of the ban on exclusive territories.

3. The study by Robert Tollison and Robert B. Ekelund, "The Economic Efficiency of Geographic Restraints in the Malt Beverage Industry," attempts to explain beer price differences among the states. I have several criticisms relating to the appropriateness of their methodology and the accuracy and interpretation of their results. In addition, I am concerned about the accuracy of their data. For Indiana they insist state law restricts newspaper and magazine advertising for beer as well as exterior sign and window advertising. Yet beer is routinely advertised in the state in newspapers by price and brand. Similar information is also provided in signs and marquees on the outside of retail liquor stores.

4. It is true that the number of beer wholesalers in Indiana has declined significantly in the last ten years. This decline is consistent with the national trend. Furthermore, before exclusive territories were prohibited in Indiana almost every county in the state had a wholesaler for each major brand. Wholesale beer franchises were initially granted in the state as part of a system of political patronage. Even today Indiana has more wholesalers per capita than the national average and more than many more populous states such as Florida, Massachusetts, New Jersey, and Virginia.

My research has suggested that the proposed legislation would severely reduce intrabrand competition, raise wholesale and retail prices, and generally be anti-competitive. As I stated in my testimony four years ago, I strongly oppose the enactment of this legislation.

Sincerely,

Bruce L. Jaffee
Professor
Business Economics
& Public Policy

BLJ:dfh

CFA Consumer Federation of America

October 22, 1987

Senator Howard Metzenbaum
Chairman, Subcommittee on Antitrust
United States Senate

Dear Senator Metzenbaum,

It has come to our attention that a witness before your Committee (Robert D. Tollison, appearing on August 4, 1987) was highly critical of a Consumer Federation study of the impact of vertical restraints. Having read the research on which his critique was based (Robert D. Tollison and Robert B. Ekelund, Jr., The Economic Efficiency of Geographic Restraints in the Malt Beverage Industry), we would suggest his report misrepresents what we and others have said and is completely misleading in its presentation of basic facts.

The enclosed paper demonstrates a variety of flaws in the Tollison/Ekelund paper. A few of the most glaring errors in the presentation of basic facts are:

- The real price increase of soft drinks is miscalculated.
- The increase in wage rates is misstated.
- Declining real prices for beer and soft drinks are touted as major achievements by these industries, but the authors fail to note that over the same time period prices for all commodities and food were also falling in real terms.
- Real, annual changes in beer prices are erroneously compared to nominal, cumulative changes in wages and taxes. Ultimately the authors are trapped in their own web of deception, incorrectly stating that real beer prices were falling while tax revenues were rising.
- The Michigan case study is misrepresented by the authors and does not support their position.

The econometric analysis presented by the authors is totally flawed.

- o The price of a related good is measured as the price of wine. Yet, exclusivity legislation affects both beer and wine franchising in almost one-third of the states. Thus, the variable used as a price of a substitute good is partly a surrogate for the impact of exclusivity. This confounds the assessment of the effect of exclusivity. The authors certainly should have known this, since this true in one of the cases they discuss.

This one error alone totally undermines the author's assertions, but there are numerous other flaws.

- o The measurement and interpretation of the price of beer are inconsistent. Either the description of the variable is wrong, or the interpretation of the coefficients is faulty.

- o Price is also specified including taxes, but taxes are a component of price that is not subject to influence of the exclusivity policy decision.

- o The consumer income variable is described as a cost-of living variable, but the variable is operationalized as total state real income and this variable has nothing to do with cost-of living differences. For example, the value for California on this variable is 2.5 times as high as the value for Ohio. The cost of living is certainly not 2.5 higher in California than Ohio. As operationalized the variable bears no relationship to the economic concept it was supposed to measure.

- o The consumption variable suffers from a similar flaw. It is expressed as the gross volume of sales in a state. For example, California has a value that is over twice as large as that of Ohio, yet Ohio and California have similar levels of consumption per capita and Ohio has higher consumption per square mile of area. These are the relevant concepts on both the supply and demand sides.

The most glaring flaws with respect to the discussion of our report include the following:

- The authors state that in evaluating the effects of the the Soft Drink Interbrand Competition Act it is necessary to consider data before and after passage of the act, which we failed to do. They are simply wrong. We clearly did consider such data. In fact, this was the basic data we presented.
- They also charge that we presented no data linking increased profitability to abuse of consumers. In fact, the central thrust of our argument was to examine price/cost data.
- The authors state that we relied solely on one set of regression results which were statistically no significant. In fact, we relied on numerous specifications of the econometric model, many of which were statistically significant, and we conducted an extensive review of the literature on the impact of exclusive territories.

In spite of the august stature of our critics, their paper is so fundamentally flawed in its presentation of the basic facts of the case -- both its critique of our evidence and the presentation of its own evidence -- that it hasn't changed our minds. We remain convinced that the current case-by-case approach to exclusive territories strikes the proper balance between protecting the interests of the consuming public and allowing industries to achieve efficient organizational structures. The scales do not have to be tipped in favor of brewers and wholesalers at the expense of retailers and the consuming public.

We urge you and the other members of Congress to continue to resist the political pressures to give the malt beverage industry a special antitrust exemption, as you have steadfastly done for the past half decade.

Sincerely,
Mark N Cooper
Mark N. Cooper
Director of Research

CFA Consumer Federation of America

THE EVIDENCE DOES NOT SUPPORT A SPECIAL ANTITRUST EXEMPTION FOR THE MALT BEVERAGE INDUSTRY

OCTOBER 1987

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

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THE EVIDENCE DOES NOT SUPPORT A SPECIAL ANTITRUST EXEMPTION FOR THE MALT BEVERAGE INDUSTRY

EXECUTIVE SUMMARY

A recent report by Robert D. Tollison and Robert B. Ekelund, Jr., The Economic Efficiency of Geographic Restraints in the Malt Beverage Industry, is highly critical of an earlier study by the Consumer Federation of America on the impact of vertical restraint. It purports to show that vertical restraint in the malt beverage industry are in the public interest. This paper shows that the Tollison/Ekelund paper is riddled with analytic flaws and that it misrepresents what we and others have written.

A few of the most glaring errors in the presentation of basic facts by Tollison and Ekelund include the following.

- The real price increase of soft drinks is miscalculated.
- The increase in wage rates is misstated.
- Declining real prices for beer and soft drinks are touted as major achievements by these industries, but the authors fail to note that, over the same time period, prices for all commodities and food were also falling in real terms.
- Real, annual changes in beer prices are erroneously compared to nominal, cumulative changes in wages and taxes. Ultimately the authors are trapped in their own web of deception, incorrectly stating that real beer prices were falling while tax revenues were rising.
- The Michigan case study is misrepresented by the authors and does not support their position.

A few of the most glaring errors in the Tollison/Ekelund econometric analysis are:

- The price of a related good is measured as the price of wine. Yet, it appears that exclusivity legislation affects both beer and wine franchising in some cases. Thus, the variable used as a price of a substitute good is really partly a surrogate for the impact of exclusivity. It confounds the assessment of the effect of exclusivity.
- The measurement and interpretation of the price of beer are inconsistent. Either the description of the variable

is wrong, or the interpretation of the coefficients is faulty.

- Price is also specified including taxes, but taxes are a component of price that is not subject to influence of the exclusivity policy decision.

- The consumer income variable is described as a cost-of living variable, but the variable is operationalized as the total real income and this variable has nothing to do with cost-of living differences. For example, the value for California on this variable is 2.5 times as high as the value for Ohio. As operationalized the variable bears no relationship to the economic concept it was supposed to measure.

- The consumption variable suffers from a similar flaw. It is expressed as the gross volume of sales in a state. For example, California has a value that is over twice as large as that of Ohio, yet Ohio and California have similar levels of consumption per capita and Ohio has higher consumption per square mile of area. These are the relevant concepts on both the supply and demand sides.

The most glaring flaws with respect to the discussion of our report include the following:

- The authors state that in evaluating the effects of the the Soft Drink Interbrand Competition Act it is necessary to consider data before and after passage of the act, which we failed to do. They are simply wrong. We clearly did consider such data. In fact, this data was the basic data we presented.

- They also charge that we presented no data linking increased profitability to abuse of consumers. In fact, the central thrust of our argument was to examine price/cost data.

- The authors state that we relied solely on one set of regression results which were statistically no significant. In fact, we relied on numerous specifications of the econometric model, many of which were statistically significant. In addition we conducted an extensive review of the literature on the impact of exclusive territories.

We remain convinced that the current case-by-case approach to exclusive territories strikes the proper balance between protecting the interests of the consuming public and allowing industries to achieve efficient organizational structures. The scales do not have to be tipped in favor of brewers and wholesalers at the expense of retailers and the consuming public.

INTRODUCTION

At a recent hearing of the Senate Subcommittee on Antitrust (August 4, 1987) Robert D. Tollison criticized CFA's analysis of the impact of vertical restraints in the malt beverage industry.[*] That criticism was combined with a defense of exclusive territories for the industry.[**] This paper documents a vast array of flaws in the criticism and counter analysis. Not only is the criticism unfounded -- misrepresenting what we and others have said -- but the counter argument is completely misleading in its presentation of basic facts and should be rejected by policymakers.

THE SOFT DRINK INDUSTRY EXAMPLE: COMPLETE MISREPRESENTATION OF CFA'S ANALYSIS

The most glaring example of the misrepresentation comes in the discussion of the soft drink industry. The soft drink industry is an interesting case since legislation was passed the industry. Moreover, the soft drink industry bears some similarities in structure to the malt beverage industry. 1980 weakening the antitrust oversight of vertical restraints in

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[*] "The Cost to Consumers of Exclusive Franchising: The Case of Malt Beverages," September 17, 1986 -- hereafter referred to as CFA.

[**] Robert D. Tollison and Robert B. Ekelund, Jr., "The Economic Efficiency of Geographic Restraints in the Malt Beverage Industry," June 1987 -- hereafter referred to as Tollison/Ekelund).

Our critics assert that

> Cooper's data and analysis, however, do not provide evidence whatsoever that the passage of SDICA caused increased rate of return to equity in the soft drink industry...
>
> Cooper's soft drink and all industry return to equity data are all post-1979. In order to argue that SDICA caused an increase in the soft drink industry return to equity a comparison of returns in the pre- and post-1980 period is necessary at a minimum (Tollison, p. A-3).

The authors appear not to have read our report (see Exhibit 1). The table presenting our analysis of return on equity was clearly labeled Five Year Average Rate of Return on Equity. It should not take a PH. D. in economics to recognize that a five year rate of return for 1980 is based on the years 1976, 1977, 1978, 1979 and 1980. If the title on the table was not clear enough, the text accompanying it certainly was.

> Return on equity figures are also revealing. In the five years before the passage of the act soft drink manufacturers earned a return on equity of 1.4 times the national average. After the passage of the act this return rose steadily up to 1.8 times the national average (CFA, p. 25, emphasis added).

We also presented net profit margin numbers on an annual basis (see Exhibit 2). These ran from 1975 to 1985 and the text was again quite clear in showing that we were making a before and after comparison.

> The net profit margin numbers (see Table 7) are most interesting. For each of the companies we observe a sharp decline in profitability in the late 1970s. This decline brings the soda manufacturers from far above the national average to close to the national average in 1980. Beginning in 1980, this trend is reversed (CFA, 25).

EXHIBIT 1:

CONCENTRATION IN THE SOFT DRINK INDUSTRY

YEAR	NUMBER OF BOTTLERS	MARKET SHARE OF THE TOP N FIRMS Number of Firms:							
		4	6	8	13	20	39	50	60
		Percent Market Share:							
1963	3129	12		19		26		36	
1967	3057								
1972	2271	14		21		32		44	
1978	1725								
1982	1552		20		32		53		62

SOURCES:

1963-1978, "Testimony of Lee E. Preston," Soft Drink Interbrand Competition Act, Hearings before the Subcommittee on Antitrust, Monopoly and Business Rights of the Committee on the Judiciary, United States Senate, No. 96-46, June 4, 1979.

1982, Beverage Industry, May 3, 1983

EXHIBIT 2:

PROFITABILITY OF SOFT DRINK MANUFACTURERS

YEAR	NET PROFIT MARGIN (in percent)						
	NATIONAL AVERAGE	SOFT DRINKS	COKE	PEPSI	COKE BOTTLE OF NY	RC	GENERAL CINEMA
1975	3.2	NA	7.8	4.4	3.3	NA	4.0
1976	4.6	NA	9.3	5.0	3.9	5.8	4.5
1977	4.7	NA	9.3	5.3	3.8	5.6	4.5
1978	5.0	NA	8.8	5.3	3.4	3.3	4.3
1979	5.3	NA	8.7	5.3	2.7	1.6	4.2
1980	5.0	NA	7.4	4.9	-	2.9	3.5
1981	4.5	NA	7.7	4.8	NA	2.7	4.6
1982	3.4	5.4	8.3	4.9	NA	2.7	5.8
1983	3.5	4.5	8.2	3.2	NA	3.4	10.1
1984	3.7	6.2	8.2	3.6	NA	NA	10.6
1985	3.8	7.8	8.6	6.9	NA	NA	12.9

SOURCE: "Annual Survey of American Industry" Forbes Magazine

We might differ on whether 1979 or 1980 should be the dividing line -- we used 1980 because the law was not enacted until late in the year and could not have had much of an impact in that year -- but the blatant misrepresentation of our analysis suggests a conscious attempt to mislead.

Continuing with the soft drink example for a moment, our critics assert that

> For the Act to have reduced consumer welfare, it must have resulted in higher prices and/or reduced output given other factors. Cooper offers no statistical evidence at all concerning the causes of the overall soft drink price trends in the 1980s but does state that soft drink prices rose by approximately 21 percent (Tollison, pp. A-5, A-6).

These authors should know that the absolute level of prices or even the level of prices relative to other goods and services are not the key issue -- it is price/cost relationships that are central. Prices may be falling and consumers may still be treated unfairly, if more rapidly falling costs are masking the exercise of market power. Again, our paper was quite clear on this point.

> Price/cost data is also supportive of our argument that exclusive franchising certainly did not help and probably hurt consumers. The price of raw cane sugar rose in 1981, compared to 1980, then turned down. It never again exceeded the 1980 price and was well below the 1980 price in 1982 and 1985 (see Table 9 -- CFA, p. 29).

We were careful to point out that a detailed cost function would be required, but comparisons of sugar and diesel fuel costs and a number of other factors suggest price cost margins had increased sharply (see Exhibit 3).

Instead of recognizing price costs relationships, the authors focus on relative prices.

> soft drink prices rose by approximately 21 percent. His suggestion that this constitutes a significant price increase is without merit in light of the fact that prices in general (inflation) rose by about 31 percent during the same period. This implies that soft drink prices adjusted for general price inflation actually decline by 10 percent over the period (Tollison, p. A-5).

There are two things wrong with this statement.

First, the arithmetic is wrong. You do not subtract CPI from the soda price index to derive real prices, you divide. I will charitably assume that the authors did not make this mistake throughout their paper.

Second, the authors never point out that the real price of all commodities was falling just as fast as the price of beer. Thus, here is an industry whose profits were increasing faster than others, in part because its input prices were falling, but whose prices were not falling faster than others.

MISLEADING AND INCORRECT PRESENTATION OF THE DATA IN THE TOLLISON/EKELUND PAPER

Throughout the paper the authors use the ploy of reporting real changes in beer prices without noting that the real price of other commodities was also falling (see Exhibit 4). The reader is given a distorted picture.

There is an even worse defect in the reporting of changes

EXHIBIT 3:

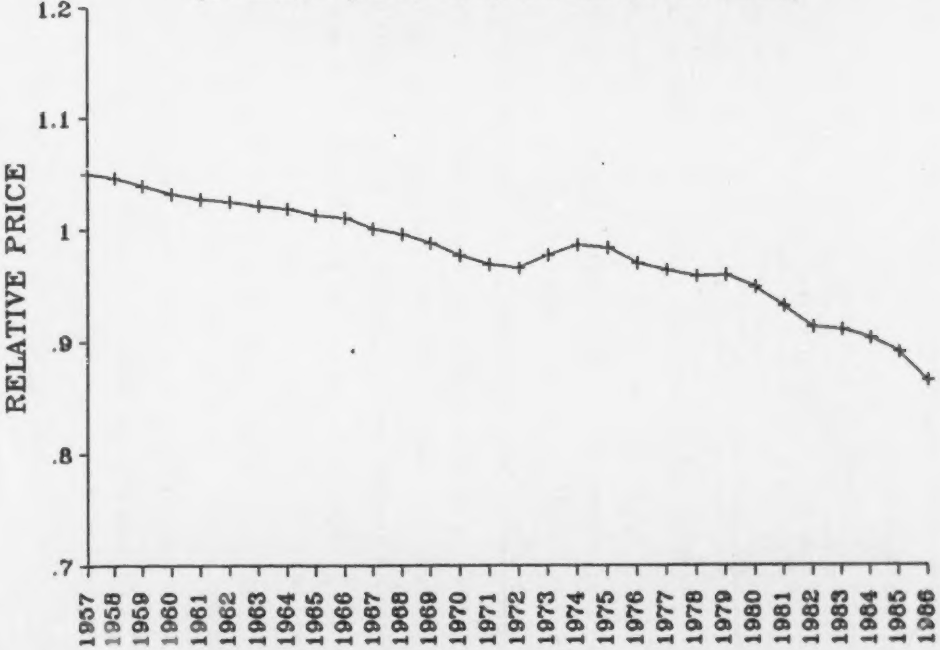
THE RETAIL PRICE OF SOFT DRINKS COMPARED TO THE COST OF THEIR PRINCIPLE PRODUCTION COMPONENTS

(Price Indices with 1980 as the Base Year)

YEAR	RETAIL PRICESa/		PRODUCER PRICES		
	COLA	SUGAR	RAW CANE SUGARb/	DIESEL FUELc/	WAGES IN BOTTLINGd/
1980	100	100	100	100	100
1981	112	119	129	126	113
1982	115	91	85	112	122
1983	114	97	99	94	131
1984	120	99	99	100	140
1985	121	97	91	93	146

SOURCES: United States, Bureau of Labor Statistics:
a/ Consumer Price Index, Detailed, Food.
b/ Producer Prices and Price Indices, Table 4.
c/ Ibid., Diesel for Commercial Users.
d/ Employment and Earning, Table C-2, Beverages

THE RELATIVE PRICE OF ALL COMMODITIES
(TOLLISON/EKELUND SCALE, 1967=100)



over time. The authors repeatedly mix their units and bases of comparison. For example, one of the central comparisons in the paper reads as follows

> Further, according to data from the Bureau of Labor Statistics, real beer prices computed in constant 1967 dollars fell at a compound rate of 1.7 percent per year from 1964 to 1985. Between 1968 and 1985, average hourly wages for production workers in the malt beverage industry rose four-fold (391%) in contrast to earnings in all manufacturing (315%) and in all food (299%) (Tollison, p. 12).

Again, there are two things wrong with the statement.

First, wages did not rise 391%, they rose only 291%. This may be just a little sloppy English.

Second, and more importantly, what we are presented with is a compounded annual real rate of change compared to cumulative nominal rates of change. Stated on an equivalent basis, the real increase in average hourly earning in the beverage industry was only 1.4 percent per year, in all manufacturing it was about .1 percent while real wages of workers in all food industries fell by .2 percent. Presenting all changes in real terms gives a very different perspective on the relative changes.

This sort of distorted comparison permeates the paper. Real changes in beer prices (Figure 6, p. 20A) are contrasted with nominal changes in wages (Figure 7, p. 21A) and taxes (Figure 8, p. 21B). The authors are then mislead by their own slight of hand.

> In spite of the high and rapidly growing wage rates in this industry, relative retail beer prices prices nonetheless experienced the decline mentioned earlier.

> Figure 8 sketches how the tax burden on the beer industry has changed over the last 29 years. In 1957 total state plus federal direct taxes on beer amounted to just over $1 billion. By 1985 these taxes had risen to nearly $3 billion. Additionally, the state tax revenues are exclusive of any general sales or gross receipts taxes collected from the sale of beer at retail. Again, even though the tax burden on the industry rose dramatically over the period, the price of beer at retail steadily declined (Tollison, p. 21).

As we have seen, real increase in wages were small over the period. Moreover, real tax revenues were actually declining. The authors seem to have been caught in their own web of deception.

The misrepresentation of comparing the increase in nominal tax collections to a decrease in real beer prices is particularly bothersome since the authors make a big point of a Michigan study which pointed to a decrease in real tax collections.

> In constant dollar terms, a six-pack that cost $1.23 in 1967 cost only 91 cents in 1983. While lamenting a loss of over 65 million dollars in state beer tax revenues, the agency called the price decline "an enviable business achievement by beer manufacturers (Tollison, p. 18).

MISINTERPRETATION OF THE MICHIGAN DATA

The citation of the Michigan study is also extremely dubious. The agency referred to was studying the tax effects of declining prices, not the effect of the exclusive territory law. If an enviable achievement took place, it may well have taken place prior to the passage of the exclusive territory law.

If the authors had bothered to look, they would have found that the Michigan data does not support their arguments (see Exhibit 5). Between 1971 and 1977, the year of the implementation of the exclusive territory law, real prices were falling by 2.2 percent per year. In the six years after the law went into effect (1977-1983) they declined much more slowly -- only 1.2 percent per year.

Excluding taxes does not alter this observation, but one might argue about when the law had full effect. Our reading of the soft drink case indicated that retailers resist the imposition of exclusive territories and we assumed a one year lag before full effect.

Using the data available to specify an econometric model that is close to the one used by the authors (parts of which are subject to debate) we find that the Michigan data contradicts their argument (see Exhibit 6). Exclusivity appears to have slowed the decline in price. The magnitude of the effect is about 3.5 percent, slightly larger than we observed in our report.

ASSORTED OTHER SLOPPINESS IN THE TOLLISON/EKELUND PAPER

The presentation of data is sloppy in other places. For example, the authors repeatedly shift the time frame and points of comparison -- beer prices for the 1964-1985 period are first compared to wages for the 1968-1985 period. A few pages later, the comparison shifts to the 1957-1985 period for all indices.

MICHIGAN BEER PRICES

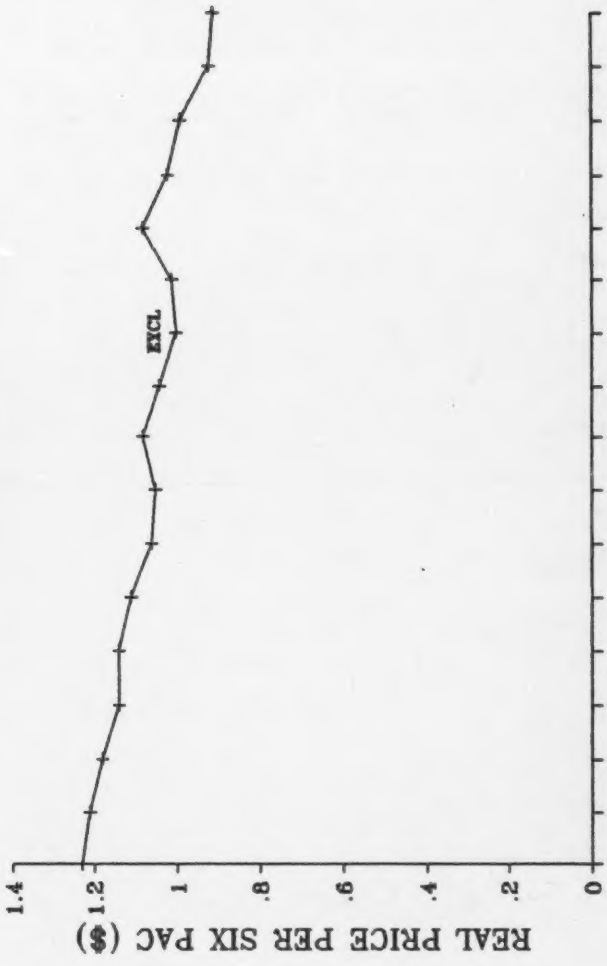


EXHIBIT 6:

THE IMPACT OF EXCLUSIVITY ON MICHIGAN BEER PRICES

(Ordinary Least Squares, Prices in constant dollars, Price net of taxes, Natural log of price, income and volume consumed, Linear trend term)

VARIABLE	B-COEFF.	T	B-COEFF	T
EXLCUSIVITY (No lag)	.04115	1.193		
EXCLUSIVITY (One year lag)			.08603	2.566
INCOME	.05893	.218	-.03634	.157
CONSUMPTION	-.07845	.266	.26841	.907
TREND	-.01519	3.388	-.02214	4.454
CONSTANT	30.74	4.378	39.7734	5.625
R2 (F-STATISTICS)	.7461	12.75	.8166	18.81

Per capita changes in total consumption of beverages are presented in Figure 4, but absolute levels of imports are presented in Figure 5. Figures 2 and 6 do not show the origins for the Y axis -- a classic maneuver to distort apparent changes.

FLAWS IN THE TOLLISON/EKELUND ECONOMETRIC ANALYSIS

The Tollison/Ekelund econometric analysis suffers from the same sloppiness that their non-econometric analysis does. Virtually every one of the variables utilized is subject to serious operational or conceptual question.

The price variable is described as real price per gallon because the nominal price is divided by the regional price index. Yet, the coefficients are interpreted as though the price variable was stated in 1984 dollars. Either the description of the variable is wrong, or the interpretation of the coefficients is faulty (compare Tollison, pp. 31 and 36).

Price is also specified including taxes, but taxes are a component of price that is not subject to influence of the exclusivity policy decision.

The consumer income variable is described as follows "the use of real state disposable income controls for the effect of general cost-of-living differences among states (Tollison, p. 31)." However, the variable is operationalized as total state real income and this has nothing to do with cost-of living differences. For example, the value for California on this variable is 2.5 times as high as the value for Ohio. Does that mean that the cost of living is 2.5 times higher in California than Ohio?

As operationalized the variable bears no relationship to the economic concept it was supposed to measure. If cost-of-living differences are the concept to be measured, then per capita income is the proper variable -- a variable which we included in our model.

The consumption variable suffers from a similar flaw. It is expressed as the gross volume of sales in a state. Again, this concept is dubious as a measure of demand as it affects price, since it is the transactions that are the central issue in distribution. For example, California has a value that is over twice as large as that of Ohio, yet Ohio and California have similar levels of of consumption per capita and Ohio has high levels of consumption per square mile of area. These are the relevant concepts on both the supply and demand sides.

The price of a related good is measured as the price of wine. Yet, it exclusivity legislation affects both beer and wine franchising in one third of the cases. This oversight is most surprising since one of the case studies cited by the authors implied as much. Thus, the variable used as a price of a substitute good is partly a surrogate for the impact of exclusivity. This completely confounds the assessment of the effect of exclusivity.

In addition, a more careful examination would indicate that

1) if alcohol is the good being measured, then

> distilled spirits are a much larger share of the alcohol market than wine (albeit smaller than beer; the Michigan study cited by the authors makes this clear) and
>
> 2) a nonalcoholic substitute should be considered since the imposition of exclusivity in franchising of the dominant good affects the competitiveness and distribution structure of all alcoholic beverages.

Exclusivity is measured as a dummy variable with those states mandating exclusivity coded as a 1. However, two states which passed exclusivity laws in 1984 were classified as exclusive in that year. The impact of a law in the year of passage may be limited. The variable should be lagged to take account of the time lag required for laws to have an impact.

MODEL SPECIFICATION AND STATISTICAL ISSUES

Econometric models of complex economic concepts with a small number of cases and imprecisely measured variables will always occasion debate. Our research cited a host of other econometric and non-econometric studies all of which contributed to our overall conclusions. Tollison/Ekelund ignore this literature and completely mischaracterize our analysis.

First, our critics asserts that by "any generally accepted degree of statistical confidence" our estimation of the dollar cost to consumers is not valid. "Traditional" levels of significance are quite arbitrary and the authors report significance levels ranging from 1% to as high as 20%.

More importantly, the assertion that our results do not achieve statistical significance is simply unfounded. We chose to use the 1984 data set to estimate dollar impacts, since it provided a very conservative estimate. The coefficients were larger than the standard errors. Had we chosen to use the larger, 1981 to 1984 data set, our estimate of the dollar impact on consumers would have been even larger. Moreover, the coefficients in that model achieve the "traditional" level of significance. This was clearly pointed out in the paper

> With respect to price, the coefficients are all larger than their standard errors. For the pooled cross-sectional, time series data, the coefficients are twice the standard error (CFA, p. 36).

Moreover, it is simply false to say that the only regression that matters was the 1984 regression in which the coefficient were larger than their standard errors (but not twice as large as the authors desire). In point of fact, we examined a range of estimates, some based on the pooled 1981-1984 regressions, some based on regressions including taxes, some based on linear and some based on logarithmic specifications.

With respect to model specification, we have several differences of opinion.

We included several years of data which the authors did not.

We conceptualized key variables differently. For example, the authors include the wage rate, which is highly correlated with income levels, as an indicator of the cost of doing business. Our literature review found that population densities and concentration were important determinants of the cost of distribution businesses. The authors make no mention of this existing literature. They use service congestion as a demand-side cost, not a supply-side cost.

They did not test any hypotheses about consumption, which could clearly be derived from the theoretical literature. If we were inclined to include consumption in an equation, we would include per capita consumption (or even consumption per square mile), since it is density that is the critical factor. We are not convinced that the level of total consumption is the relevant supply-side cost factor.

We analyzed the consumer price excluding taxes, since there is no expected relationship between exclusivity and taxes, and also examined wholesale prices and dealer mark-up, which they did not.

We included measures of concentration in our analysis, they did not. The authors repeatedly cite the number of brewers as evidence that this is a competitive industry, but they reject the notion that the market shares of the brewers is relevant. If the number of brewers is so important, so is their size. As theoretical evidence to support this notion they cite contestability -- the threat of entry by potential competitors. Yet, contestability theory has been empirically disproven in the one industry to which it has been subject to empirical test -- the airline industry (an industry to which the authors make passing reference).

CONCLUSION

In spite of the august stature of our critics, their paper is so fundamentally flawed in its presentation of the basic facts of the case -- both its critique of our evidence and the presentation of its own evidence -- that it hasn't changed our minds.

We remain convinced that the current case-by-case approach to exclusive territories strikes the proper balance between protecting the interests of the consuming public and allowing industries to achieve efficient organizational structures. The scales do not have to be tipped in favor of brewers.

We believe that Congress should continue to resist the political pressures to give this industry a special antitrust exemption.

JONES, DAY, REAVIS & POGUE

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November 17, 1987

The Honorable Dennis DeConcini
Committee on the Judiciary
United States Senate
Washington, D.C. 20510-6275

Dear Senator DeConcini:

At the request of your staff, I have reviewed the additional materials concerning the testimony given at the August 4, 1987 hearing on S. 567, The Malt Beverage Interbrand Competition Act ("MBICA"), and offer the following comments on behalf of the National Beer Wholesalers' Association ("NBWA").

None of the comments submitted by opponents of the MBICA has caused the NBWA to rethink its support for S. 567. For the most part, the comments are limited to a recitation of the time-worn arguments previously asserted in opposition to this legislation. The NBWA has responded to these arguments on numerous occasions and, indeed, on September 28, 1987, I specifically addressed the issues contained in the August 12, 1987 letter, submitted by New York state attorney general Robert Abrams.

Since the most recent hearings on August 4, 1987, however, there have been two significant judicial decisions involving the issues raised by S. 567. The first, the Healy case, found that beer prices in New York City are the most competitive in the Northeast -- even though exclusive territories are used in that market. Specifically, on September 11, 1987, the U.S. District Court for the District of Connecticut issued an opinion in United States Brewers Ass'n v. Healy, No. 14-84-816 (PCD) (D. Conn.) (Attachment 1). This decision represents the most recent opinion in a long-running legal challenge to the constitutionality of the state of Connecticut's liquor price-posting law. While this issue is not directly related to the concerns of S. 567, the opinion in Healy contains an important judicial finding that contradicts the New York State attorney general's unproved claim that beer prices in New York State are disproportionately higher as a result of the use of exclusive territories.

Previous opinions issued in the *Healy* litigation had recognized the vigor of price competition in the New York City area. In the initial district court opinion in 1982, the court found that "[t]he New York City market *is the most highly competitive*" of Connecticut's neighboring states and "accordingly, prices there are often the lowest in the four-state area." 532 F.2d 1312, 1320 (D. Conn. 1982)(emphasis added). In the same year, the U.S. Court of Appeals for the Second Circuit similarly found:

> Historically, the retail price of beer has been generally higher in Connecticut than in its neighboring states, *i.e.*, Massachusetts, New York and Rhode Island. As a consequence, Connecticut residents have crossed state borders in significant numbers to purchase beer in other states at lower retail prices.

692 F.2d 275, 282-83 (2d Cir. 1982), *aff'd without opinion*, 464 U.S. 909 (1983).

In issuing its most recent opinion on remand, the district court in *Healy* again noted: "*It is agreed by all parties that the New York City market is the most competitive and prices there are the lowest in the four-state region.*" Slip op. at 2 (Sept. 11, 1987) (emphasis added). The judicial opinions in *Healy*, which span the period in which exclusive territories were initiated by the leading brewers in New York, demonstrate the continuing competitiveness of the New York beer market. As a result, they decisively refute the claimed price increases allegedly associated with exclusive territories.

The second district court opinion, *Package Shop*, addresses even more directly the issues presented by the MBICA. In *Package Shop, Inc. v. Anheuser-Busch, Inc.*, No. 83-0513 (D.N.J. Oct. 19, 1987) (Attachment 2), the district court dismissed a lawsuit by a class of beer retailers in New Jersey who claimed that Anheuser-Busch and Miller wholesalers had entered into a conspiracy to allocate territories for the exclusive distribution of beer in that state. These allegations, of course, are strikingly similar to some of those raised by the New York state attorney general in his ongoing lawsuit against four brewers and selected wholesalers in New York.

Prior to a trial on the merits, the court ruled in favor of the beer wholesalers in New Jersey on all counts and dismissed the complaint. It found that the allocation of exclusive territories was not the result of a wholesalers' conspiracy but rather the product of a longstanding and clear business policy implemented by the brewers, who required their wholesalers to sell only within defined areas of primary responsibility. The opinion reflects a thoughtful analysis of the business considerations that motivate the use of exclusive territories or areas of primary responsibility.

The court further found that the retailers had not been damaged by any refusal to sell beer outside of areas of primary responsibility because there was sufficient competition among the different brands of beer to assure competitive wholesaler prices. As a result, the Package Shop opinion supports the approach of the MBICA, which would find no basis for an antitrust violation given the presence of "substantial and effective" interbrand competition.

The Package Shop opinion also contains evidence refuting the claim that beer prices are lower in Indiana, the only state that forbids the use of exclusive territories. Rejecting a study of Indiana beer prices proffered by the plaintiffs, the court found that the prices for Anheuser-Busch products in Indiana "were on average no lower than the prices" in New Jersey. This finding thus contradicts the repeated assertion that exclusive territories result in higher prices and that forbidding this practice would reduce prices.

Finally, the Package Shop decision dramatically demonstrates the costs of litigation concerning the use of exclusive territories. The complaint in that case was filed in February 1983 and, even relying on summary procedures, dismissal of the complaint was not obtained until October 1987. It has been estimated by an industry newsletter that the Package Shop litigation cost the defendants a total of $3 million. (See Attachment 3). These costs, of course, are ultimately passed on to consumers in the form of higher prices for beer.

I hope this information is helpful to you and the Committee. If I can be of further assistance, please do not hesitate to contact me.

Sincerely,

Ernest Gellhorn

Ernest Gellhorn

Attachments

cc: Matthew McCoy, Esq. (w/attachments)

Attachment 1

CLIENT IDENTIFIER: 890425-702-300
DATE OF REQUEST: 10/15/87
THE CURRENT DATABASE IS DCT
YOUR QUERY:

TI("UNITED STATES BREWERS" & HEALY)

Citation	Rank(R)	Database	Mode
--- F.Supp. ----	R 1 OF 3	DCT	P

UNITED STATES BREWERS ASSOCIATION, et al.
v.
John T. **HEALY**, et al.
Civ. No. H-84-816(PCD).
United States District Court, D. Connecticut.
Sept. 11, 1987.
RULING ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

DORSEY, District Judge.

Plaintiffs are the United States Brewers Association ("USBA")--an industry association of thirty-nine domestic brewers and twenty-three importers of beer--and those of its member companies who sell beer in Connecticut and in the bordering states of Massachusetts, New York and Rhode Island.

Defendants are the Commissioners and Secretary of the Connecticut Department of Liquor Control.

Intervening defendant Wine & Spirits Wholesalers of Connecticut is a trade association of seven companies which sell alcoholic beverages, including beer, at wholesale within Connecticut.

Plaintiffs' complaint seeks a declaratory judgment that the beer price affirmation provisions of Conn.Pub.Act 84332, [FN1] 84-432 [FN2] and s 30-63a(b) of the Connecticut Liquor Control Act [FN3] violate the commerce clause [FN4] and the supremacy clause [FN5] of the United States Constitution. Plaintiffs also seek a permanent injunction to restrain defendants from enforcing these statutes.

Currently pending are cross-motions for summary judgment, which have been exhaustively and intelligently briefed and rebriefed by the USBA, the intervening defendants and the State Attorney General's Office. For the reasons that follow, USBA's motion is denied, and the motion of defendants and

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intervening defendants is granted.

I. Background

A. The Beer Industry [FN6]

The beer industry in Connecticut is divided into three marketing levels: (1) brewers and importers; (2) wholesalers; and (3) retailers. Each market participant must hold a valid Connecticut license to sell, in Connecticut, alcoholic beverages to the tier below and, ultimately, to consumers.

The brewers and importers market national brands such as Budweiser or Miller High Life, and regional or local brands such as Genesee Cream Ale or Piels. There are no breweries in Connecticut. All beer--national or regional--is shipped into Connecticut by brewers and importers designated as "out-of-state shippers" under Connecticut law.

Plaintiffs contend that prices charged and package configurations offered to wholesalers in Connecticut and the bordering states vary in the several markets within the four state area. (Market areas do not always coincide with state borders.) In certain markets, regional brewers or importers price their beers to allow sales to consumers at the lowest prices possible in those markets. Other brewers or importers competing in these areas must consider this competitive pricing in pricing their own product. It is agreed by all parties that the New York City market is the most competitive and prices there are the lowest in the four-state region. Other factors which have an impact on pricing and marketing decisions, such as consumer tastes, packaging, costs and freight, vary from area to area even within these states. Thus, according to plaintiffs, a variable pricing and marketing structure has emerged in Connecticut and the bordering states which results in substantial interstate competition in retail beer sales.

In Connecticut, typically more than one wholesaler sells an out-of-state shipper's products. Each wholesaler generally handles products of more than one out-of-state shipper but is restricted by law from selling to retailers outside its assigned geographical territory.

The primary retail outlets for off-premise consumption of beer in Connecticut are package and grocery stores. Retailers, particularly near the borders, face substantial competition from retail beer outlets in the bordering states. Although prices charged to Connecticut wholesalers are neither the highest nor the lowest in the four-state region, retail prices historically have been higher in Connecticut. Accordingly, many Connecticut residents have purchased beer at lower retail prices in New York, Massachusetts or Rhode Island.

B. Price Affirmation

In 1981, Connecticut amended its Liquor Control Act by adding beer price affirmination provisions. The Act required out-of-state shippers to post, each month, the bottle, can and case price for the brands of beer each sells in Connecticut. The amendment required shippers to execute written affirmations under oath certifying that the posted prices "will be no higher than the lowest price at which each such item of beer is or will be sold ... to any wholesaler in any state bordering this state, at any time during the calendar month covered by such posting." Liquor Control Act s 30-63b(b), as originally amended by Section 12 of Conn.Pub.Act 81-294 (emphasis added). No brewer or importer could sell beer to a wholesaler in Connecticut at a price higher than the lowest price then charged any wholesaler in any state bordering Connecticut. Liquor Control Act s 30-633a(b), as originally amended by Section 11 of Conn.Pub.Act 81-294. Once posted, the affirmed price became the

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controlling or fixed price for the ensuing month for the out-of-state shipper's products in Connecticut. Rebates, discounts, special promotions and other inducements which lowered the price of beer in the border states required the price to be lowered in Connecticut, but differentials in price were permitted for different state taxes and delivery costs. No allowance was made for different package configurations (e.g., a case of six-packs versus a case of loose cans or bottles), yet for any brand a brewer offered for sale in Connecticut, it had to offer Connecticut wholesalers all the units of that brand offered to wholesalers in the border states.

Thus brewers and importers in the four-state area had the following alternatives: (1) lower their Connecticut prices to equal the lowest price in any bordering state; (2) raise prices in border states to the Connecticut levels; (3) withdraw from Connecticut the brands of beer sold at lower prices in the border states; or (4) withdraw from the border states the brands of beer sold at lower prices than the Connecticut price.

The 1981 amendments were upheld by the district court, United States Brewers Ass'n v. Healy, 532 F.Supp. 1312 (D.Conn.1982), but declared unconstitutional by the Second Circuit, United States Brewers Ass'n v. Healy, 692 F.2d 275 (2d Cir.1982) (hereinafter "Healy I "), aff'd without opinion, 464 U.S. 909 (1983). The Court of Appeals held that the price affirmation provisions impermissibly burdened interstate commerce and that the twenty-first amendment [FN7] did not authorize Connecticut to set minimum prices of beer in any other state.

Thereafter, Connecticut enacted the different version of beer price affirmation set out in notes 1-2, supra. Instead of requiring out-of-state brewers and importers to certify that their prices "will be" no lower in any of the border states during the month following the posting of prices in Connecticut, the new statute requires only that at the moment of affirmation the prices charged to Connecticut wholesalers are no higher than the lowest price then being charged in any border state.

C. The Present Controversy

In their complaint, plaintiffs originally alleged that:

> the interaction of the posting and affirmation provisions of Pub.Act 84-332 with Section 30-63a(b) of the Liquor Control Act not only limits the price at which out-of-state shippers may sell to Connecticut wholesalers, but also sets the lowest price which an out-of-state shipper may charge anywhere in the Border States during the succeeding month. Thus, as under the original price affirmation scheme, an out-of-state shipper is not free to lower any Border State price below the previously affirmed Connecticut price.

Complaint at 14. They argue that the new provisions violate the supremacy clause by requiring out-of-state shippers to establish and maintain minimum prices for each item of beer in the four-state area and by precluding them from dealing with any of their customers except on the same or more favorable terms as they dealt with other of their customers, viz, Connecticut was forcing them to eng.age in conduct prohibited by federal antitrust laws.

Defendants conceded that, "standing alone," Conn.Gen.Stat. s 30-63a(b), which was not amended following Healy I, appeared to prohibit the lowering of out-of-state prices of products sold in connecticut during the entire month following the posting of Connecticut prices for that produuct. Defendants' Brief on Motion for Summary Judgment at 8. However, defendants contend that such an interpretation flies in the face of Conn.Pub.Act 84-332 which explicitly

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recognizes the right of out-of-state shippers to raise or lower their prices outside Connecticut at any time during the month following posting. In further support of their position, defendants filed a declaration and ruling by the Connecticut Liquor Control Commission. [FN8] The ruling made clear that, whatever the import of s 30-63a(b), out-of-state shippers need only affirm that at the time of posting in Connecticut (and only at the time of posting), their prices to Connecticut wholesalers are no higher than in the border states. [FN9]

After the Commission's ruling, [FN10] plaintiffs withdrew their claim based on the supremacy clause and conceded that the affirmation laws, as interpreted by the Commission, would not directly control prices in the border states. Plaintiffs' Memorandum in Support of Their Cross-Motion for Partial Summary Judgment at 18. However, plaintiffs persist in their claim that the affirmation provisions on their face and as applied,

> are purely protectionist legislation designed to protect in-state wholesalers and retailers at the expense of out-of-state brewers, wholesalers and retailers. The purpose and effect of the new law is precisely the same as the old law--discouraging purchases of beer by Connecticut residents in the Border States by requiring the brewers to offer their products to Connecticut wholesalers at prices which are artificially lower than competition would warrant, or conversely, to artificially raise their prices to Border State wholesalers.

Id. at 19.

Plaintiffs' cross-motion for summary judgment is, thus, bottomed on the unconstitutionality of the amended price affirmation law. Conversely, defendants' motion is based on the claim that the legislation is constitutional.

II. Discussion

A. Summary Judgment Standard

To grant a motion for summary judgment, there can be no "genuine issue as to any material fact" and the moving party must be "entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c); Schwabenbaur v. Board of Educ., 667 F.2d 305, 313 (2d Cir.1981). "The burden is on the moving party to demonstrate the absence of any material factual issue genuinely in dispute." American Int'l Group, Inc. v. London American Int'l Corp., 664 F.2d 348, 351 (2d Cir.1981), quoting Heyman v. Commerce & Indus. Ins. Co., 524 F.2d 1317, 1319-20 (2d Cir.1975). Moreover, there must be no controversy as to inferences which may be drawn from the facts of record. Phoenix Sav. & Loan, Inc. v. Aetna Cas. & Sur. Co., 381 F.2d 245, 249 (4th Cir.1967). In determining whether or not there is a genuine factual issue in the case, the court must "resolve all ambiguities and draw all reasonable inferences against the moving party." Schwabenbauer, 667 F.2d at 313; see also United States v. Diebold, Inc., 369 U.S. 654, 655 (1962) (per curiam); Quinn v. Syracuse Model Neighborhood Corp., 613 F.2d 438, 445 (2d Cir.1980). However, one against whom summary judgment is sought cannot rely on factually unsubstantiated conclusory allegations to sustain a claim that questions of fact exist. Celotex Corp. v. Catrett, 106 S.Ct. 2548, 2552-53 (1986). That both sides have moved for summary judgment "does not mean that the court must grant judgment as a matter of law for one side or the other," Schwabenbaur, 667 F.2d at 314, and it is error to "assume that no material facts remain in dispute simply because both parties moved for summary judgment." In re Citizens Loan & Sav. Co., 621 F.2d 911, 913 (8th

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Cir.1980) (citation omitted).

B. The Commerce Clause and the Twenty-first Amendment

Judges must not, in the exercise of the judicial function, undertake to second-guess the political judgment of legislators. Quite to the contrary, judges must refrain from reading their own policy preferences into the Constitution by striking down legislation deemed to be unwise or even foolish. See, e.g., Lochner v. New York, 198 U.S. 45 (1905); see also 324 Liquor Corp. v. Duffy, 107 S.Ct. 720, 733-34 (1987). Although courts must determine whether a challenged statute is or is not constitutional--a task concededly involving judgment and interpretation--legislation is presumed constitutional unless clearly shown not to be so. State v. Warren, 169 Conn. 207, 217 (1975). Moreover, where a statute permits of two constructions, one valid and the other invalid as unconstitutional, the valid construction should be adopted "even where it is not the obvious one." Lublin v. Brown, 168 Conn. 212, 219-20 (1975).

A state's authority to regulate aspects of the liquor industry is greater than other areas of regulation by virtue of the twenty-first amendment. Section 2 of that amendment provides: "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors in violation of the laws thereof, is hereby prohibited." Section 2 "grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system." California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97, 110 (1980). Because a state may entirely exclude alcoholic beverages from its markets, less restrictive forms of regulation are within a state's authority.

The Twenty-first Amendment thus gives the states broad power to ban, restrict, or otherwise regulate importation and in-state traffic in alcoholic beverages and thereby eliminates some of the otherwise applicable Commerce Clause constraints. For example, a state may prohibit entirely the sale of intoxicating liquors within its borders, see State Board of Equalization v. Young's Market Co., 299 U.S. 59, 62-63 (1936) although under traditional Commerce Clause limitations it could not ban the sale of other products, see, e.g., Baldwin v. G.A.F. Seelig, Inc., 294 U.S. [514,] 521 [(1935)] (wholesome milk).... Or a state may prohibit local dealers from selling beer manufactured in another state on the ground that the latter state discriminate against beer manufactured in the first state, see Indianapolis Brewing Co. v Liquor Control Commission, 305 U.S. 391 (1939), although it would not be free to impose the same type of restrictions with respect to milk, see Great Atlantic & Pacific Tea Co. v. Cottrell, 424 U.S. 366 (1976); nor could it constitutionally prohibit the exportation of local ground water to another state on the basis that the latter state would forbid exportation of its water to the first state, see Sporhase v. Nebraska, 458 U.S. 941 (1982).

Healy I, 692 F.2d at 280-281 (other citations omitted). [FN11]

However, as Healy I states, not even in the area of regulating intoxicating beverages is the authority of a state absolute. [FN12] The twenty-first amendment "has not operated totally to repeal the Commerce Clause in the area of the regulation of traffic in liquor." Joseph E. Seagram & Sons v. Hostetter, 384 U.S. 35, 42 (1966). The commerce clause--though worded as a grant of affirmative power to Congress--has traditionally been interpreted to limit state action which affects economic activities outside its own borders.

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"In general the Commerce Clause is viewed as intending to promote free trade among the states and to liberate the flow of articles in commerce from the provincialism evident in local regulations." Healy I, 692 F.2d at 278. [FN13] State statutes which directly discriminate against interstate commerce or which favor in-state economic interests over out-of-state interests are per se unconstitutional. See, e.g., City of Philadelphia v. New Jersey, 437 U.S. 617 (1978); Bacchus Imports. Even where a state statute "regulates even handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental," it will not be sustained if "the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (citations omitted). "[T]here is no clear line separating the category of state regulation that is virtually per se invalid under the Commerce Clause, and the category subject to the Pike v. Bruce Church balancing approach. In either situation the critical consideration is the overall effect of the statute on both local and interstate activity." Brown-Forman, 106 S.Ct. at 2084.

Thus, "the Twenty-first Amendment and the Commerce Clause 'each must be considered in light of the other and in the context of the issues and interests at stake in any concrete case." Id. at 2087, quoting Hostetter v. Idlewild Bon Voyage Liquor Corp., 377 U.S. 324, 332 (1964); see Midcal, 445 U.S. at 109 (what is required in this area is a "pragmatic effort to harmonize state and federal powers").

C. The Affirmation Issue

Against the foregoing general principles, the cases in the field of liquor affirmation must be examined for their application to the legislation adopted by Connecticut.

In Seagram, the Supreme Court unanimously upheld a New York requirement that alcoholic beverage brand owners affirm that the price charged to New York wholesalers was "no higher than the lowest price" than was charged anywhere in the country in the preceding month.

> The mere fact that s 9 [the price affirmation section] is geared to appellant's pricing policies in other States is not sufficient to invalidate the statute. As part of its regulatory scheme for the sale of liquor, New York may constitutionally insist that liquor prices to domestic wholesalers and retailers be as low as prices offered elsewhere in the country. The serious discriminatory effects of s 9 alleged by appellants on their business outside New York are largely matters of conjecture .... It will be time enough to assess the alleged extraterritorial effects of s 9 when a case arises that clearly presents them. "The mere fact that state action may have repercussions beyond state lines is of no judicial significance so long as the action is not within that domain which the Constitution forbids."

Seagram, 384 U.S. at 43, quoting Osborn v. Ozlin, 310 U.S. 53, 62 (1940). Although the Court thus rejected the argument that the New York affirmation law was facially invalid, it made clear that future decisions would depend on the facts of each case. See id. at 52 ("it is possible that specific future application of [the statute] may engender concrete applications of constitutional dimension").

Indeed, the next challenge to New York's affirmation law, the challenge was successful. In Brown-Forman, the Court declared unconstitutional an amended version which required distillers to affirm that the price charged to New York wholesalers "is no higher than the lowest price at which such item of liquor

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will be sold by such [distiller] to any wholesaler anywhere" in the nation. Alcoholic Beverage Control Law s 101-b(3)(d) (McKinney Supp.1986) (emphasis added). The Court stressed the fact that, by requiring such an affirmation, New York made it illegal for distillers to reduce prices in other states during the following month in which the posted New York prices were in effect. By so doing, New York had " 'project[ed] its legislation' into other States" in violation of the commerce clause. Brown-Forman, 106 S.Ct. at 2087, quoting Seelig, 294 U.S. at 52.

> While a State may seek lower prices for its consumers, it may not insist that producers or consumers in other States surrender whatever competitive advantages they may possess. Economic protectionism is not limited to attempts to convey advantages on local merchants; it may include attempts to give local consumers an advantage over consumers in other States.... The mere fact that the effects of New York's [affirmation law] are triggered only by sales of liquor within the State of New York ... does not validate the law if it regulates the out-of-state transactions of distillers who sell in-state.

Id. at 2085.

The Court distinguished Seagram on the ground that the earlier version of New York's affirmation law was retrospective in nature--requiring only that the affirmed price be no higher than the lowest price at which sales were made during the previous month--whereas the amended version was prospective. Thus, the earlier version regulated the price charged in New York in relation to prices charged outside the state, whereas the later version limited prices charged outside the state for the month after the price was posted in New York. This was precisely the distinction relied on by the Second Circuit in Healy I in striking down Connecticut's original beer price affirmation law (which also had a prospective reach).

> The New York statute [in Seagram] differed significantly from the Connecticut statute, because, unlike Connecticut's [original] beer price affirmation provisions which control brewers' future conduct in the states surrounding Connecticut, the New York law in Seagram merely required that New York prices reflect what had been charged elsewhere in the past. Thus, the New York law, although it affected the prices that manufacturers would choose to set in other states, did not limit the freedom of a manufacturer at any given time to raise or lower prices in any other state.

692 F.2d at 283.

Brown-Forman explicitly embraced Healy I:

> We agree with ... the Healy court that a "prospective" statute such as Connecticut's [original] beer affirmation statute, or New York's liquor affirmation statute, regulates out-of-state transactions in violation of the Commerce Clause. Once a distiller has posted prices in New York, it is not free to change its prices elsewhere in the United States during the relevant month. Forcing a merchant to seek regulatory approval in one State before undertaking a transaction in another directly regulates interstate commerce.... While New York may regulate the sale of liquor within its borders, and may seek lower prices for its residents [as it did in Seagram], it may not "project its legislation into [other States] by regulating the price to be paid" for liquor in those States.

Id. at 2086 (citations omitted).

The 1984 amendments to Connecticut's beer affirmation statute make the affirmation statute neither retrospective nor prospective but, rather,

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contemporaneous. Brewers must affirm that the price charged at 10:00 a.m. on the sixth day of each month to Connecticut wholesalers is no higher--at that moment--than the lowest price then being charged to wholesalers in the border states. The posted price must remain in effect in Connecticut for one month. Nonetheless, brewers and importers are free to raise or lower their prices in the border states. Of course a brewer or importer is still obliged to factor into its business decisions the recognition that its lowest price in any of the border states on the day of posting must be offered to Connecticut wholesalers for the ensuing month. The issue in the instant case, therefore, is whether Connecticut's requirement that prices to its wholesalers be fixed by pricing decisions in other states violates the commerce clause.

There is little doubt that Connecticut's present affirmation law would be constitutional under Seagram. The difficulty lies in assessing Seagram's precedent vitality. Brown-Forman decided only the questions presented in that case and left open the constitutionality of affirmation statutes less oppressive than the prospective legislation there struck down. Although the Court appeared to emphasize that the different result from that in Seagram resulted from the difference between retrospective and prospective affirmation laws, the Court qualified its analysis:

> While we hold that New York's prospective price affirmation statute violates the Commerce Clause, we do not necessarily attach constitutional significance to the difference between a prospective statute and the retrospective statute at issue in Seagram. Indeed, one could argue that the effects of the statute in Seagram do not differ markedly from the effects of the statute at issue in the present case. If there is a conflict between today's decision and the Seagram decision, however, there will be time enough to address that conflict should a case arise involving a retrospective statute. Because no such statute is before us now, we need not consider the continuing validity of Seagram.

Id. at 2087 n.6. Justice Blackmun, who joined the opinion of the Court (except for footnote 6), filed a concurrence to state that he "would go further and overrule" Seagram, which he characterized as "a relic of the past":

> [Seagram] was decided when affirmation statutes were comparatively new and long before the proliferation of overlapping and potentially conflicting affirmation statutes that has taken place in the last two decades. I see no principled distinction that can be drawn for constitutional analysis between New York's current prospective statute and the same State's retroactive statute upheld in Seagram.... Either type, despite one's best efforts at fine tuning, operates to affect out-of-state transactions and violates the Commerce Clause. Our failure to overrule Seagram now merely preserves uncertainty and will breed or necessitate further litigation. We should face reality and overrule Seagram.

Id. at 2088.

Despite the "uncertainty" referred to by Justice Blackmun, Connecticut's beer affirmation statute is here held to be constitutional. Such a finding comports with the presumption of validity to which all economic regulatory legislation is entitled. Such a finding comports, also, with the spirit of the twenty-first amendment, which was intended to return broad control of the liquor industry to the states. And it accords with dicta in Healy I to the effect that "[g]iven the latitude allowed a state under the Twenty-first Amendment ... Seagram might well validate beer price regulation less intrusive than the present Connecticut statute, such as a requirement simply that a brewer set its Connecticut prices at the lowest levels it chooses to set in the surrounding

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states ... leaving those out-of-state prices unregulated by Connecticut." Seagram, 692 F.2d at 283-284.

Above all, such a finding is consistent with the Supreme Court's interpretation of the commerce clause as it has evolved to date. Whatever the future fate of Seagram, no other Justice joined Blackmun's call in Brown-Forman for its demise; it remains to be considered by lower courts, unless and until it is formally overruled. Cf. Healy I, 532 F.Supp. at 1325 n.48 (rejecting USBA's argument that Seagram must be relegated to a "different era" of constitutional adjudication). Under Seagram, Connecticut's affirmation statute is facially valid because, unlike the version in Healy I and Brown-Forman, it leaves brewers free to raise or lower prices in the border states before and after posting in Connecticut and does not, therefore, regulate interstate commerce. Although plaintiffs cite numerous excerpts from the legislative debates over beer price affirmation to show that many voted for the measure intended it to protect local wholesalers and retailers from the competition of wholesalers and retailers in the border states, [FN14] the price flexibility provided by the latest amendments destroys much, if not all, of the force of their argument. Moreover, Connecticut is not seeking lower or better prices for its wholesalers relative to out-of-state wholesalers, but simply equal prices. "The legislative intent to secure 'fairer' or 'more equal' competition can hardly be characterized as 'protectionist' within the meaning of the Commerce Clause." Healy I, 532 F.Supp. at 1323.

In addition to being facially valid, the statute also passes muster under the second of the two-tier standard enunciated in Pike. "[T]he critical consideration"--under either test--"is the overall effect of the statute on both local and interstate activity." Brown-Forman, 106 S.Ct. at 2084. Crediting USBA's assertions that some business of Connecticut residents previously going to border state retailers will shift to Connecticut retailers, and that some "artificially" high prices (in the border states) and/or some "artificially" low prices (in Connecticut) will result from beer price affirmation even as amended, the "mere fact" that an affirmation law "is geared to ... pricing policies in other States is not sufficient to invalidate the statute" because a state may "constitutionally insist that liquor prices to domestic wholesalers and retailers be as low as prices offered elsewhere in the country," Seagram, 384 U.S. at 43, and because a "non-discriminatory regulation serving substantial state purposes is not invalid simply because it causes some business to shift from a predominantly out-of-state industry to a predominantly in-state industry." Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 474 (1981). Any state economic regulatory legislation exerts some impact on interstate commerce and courts should be cautious in striking down such legislation merely because "the faintest economic ripples begin to flow outside state borders ...." Brown-Forman, 106 S.Ct. at 2091 n.8 (Stevens, J., dissenting). The disincentive to Connecticut consumers to buy outside the state, not shown to be of more than minor economic significance, and the necessity that brewers set their prices in the border states knowing that they are simultaneously setting their prices in Connecticut are not excessive intrusion on commerce. Because Connecticut's statute operates even-handedly and serves a legitimate purpose in reducing discrimination in pricing to wholesalers in Connecticut as opposed to out-of-state wholesalers, such incidental and indirect burdens on interstate commerce do not outweigh the resulting local benefits.

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Finally, it is worth noting that the commerce clause, though often construed as restrictive of a state's authority, does not prohibit anything. It is a positive grant of authority to Congress to regulate matters of national economic importance. Since Connecticut is only one of over thirty states with affirmation laws, the problems posed by "over-lapping and potentially conflicting affirmation statutes," id. at 2088 (Blackmun, J., concurring) [FN15] are appropriate subjects for Congress to address--consistent, of course, with the limits imposed on both Congress and courts by the twenty-first amendment. To date, Congress has not done so. Plaintiffs may press their case in the national legislative arena, a better use of the powers created by the Constitution than to have this court strike down state regulatory legislation with a legitimate local purpose that does not impermissibly burden interstate commerce.

Accordingly, defendants' motion for summary judgment is granted.

SO ORDERED.

FN1. Conn.Pub.Act 84-332 provides, in relevant part:

> Each manufacturer, wholesaler and out-of-state shipper permittee shall post with the department on a monthly basis, the bottle, can and case price, and for beer, the price per keg or barrel or fractional unit thereof, of any brand of goods offered for sale in Connecticut, which price when so posted shall be the controlling price for such manufacturer, wholesaler and out-of-state shipper permittee for the month following such posting.... .
>
> ....
>
> At the time of posting of the bottle, can, keg or barrel and case price ..., every holder of a manufacturer or out-of-state shipper's permit, or the authorized representative of a manufacturer, shall file with the department of liquor control a written affirmation under oath by the manufacturer or out-of-state shipper of each brand of beer posted certifying that at the time of posting the bottle, can or case price, or price per keg, barrel or fractional unit thereof, to the wholesaler permittees is no higher than the lowest price at which each such item of beer is sold, offered for sale, shipped, transported or delivered by such manufacturer or out-of-state shipper to any wholesaler in any state bordering this state....
>
> ....
>
> This section shall not prohibit a manufacturer or out-of-state shipper permittee or the authorized representative of a manufacturer from changing prices to any wholesaler in any other state ... at any time during the calendar month covered by such posting....
>
> In determining the lowest price for which any item of beer is or was sold ... at the time of posting, appropriate reductions will be made for all discounts, rebates, free goods, allowances and other inducements of any kind whatsoever, including depletion and floor-stock allowances, offered or given to any such wholesaler; provided that differentials in price which make only due allowance for the actual costs of delivery are permissible.... A manufacturer or out-of-state shipper of beer shall offer to Connecticut wholesalers all of the sizes, approved by the department of liquor control, of his brand which he offers to any wholesaler in any state bordering this state....

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FN2. Conn.Pub.Act 84-432 provides, in part: "In determining the lowest price for which any item of beer is or was sold, offered for sale, shipped, transported or delivered during such posted period by any manufacturer or out-of-state shipper to a wholesaler in any state bordering this state, [only differentials in price attributable to differences in state taxes and to delivery costs are permissible."

FN3. Section 30-63a(b), Conn.Gen.Stat., provides, in part, that:
No holder of any manufacturer or out-of-state shipper's permit shall ship, transport or deliver within this state, or sell or offer for sale to a wholesaler permittee any brand of beer ... at a bottle, can or case price, or price per keg, barrel or fractional unit thereof, higher than the lowest price at which such item is then being sold or offered for sale or shipped, transported or delivered by such manufacturer or out-of-state shipper to any wholesaler in any state bordering this state.

FN4. "Congress shall have Power ... To regulate Commerce ... among the several States ...." U.S.Const. art. I, s 8, cl. 4.

FN5. "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof ... shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S.Const. art. VI, cl. 2.

FN6. This description is based on submissions of the parties as well as the findings of Blumenfeld, J., in United States Brewers Ass'n v. Healy, 532 F.Supp. 1312 (D.Conn.), rev'd, 692 F.2d 275 (1982), aff'd, 464 U.S. 909 (1983).

FN7. "The transportation or importation into any State ... for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." U.S.Const. amend. XXI, s 2.

FN8. Conn.Gen.Stat. s 4-176 states that the Liquor Control Commission "may, in its discretion, issue declaratory rulings as to the applicability of any statutory provision or of any regulation or order of the agency ...."

FN9. The Commission stated:
[W]e must interpret [s 30-63a(b)] in light of the obvious intention of the Connecticut General Assembly .... Accordingly, we determine and declare that C.G.S. s 30-63a(b) mandates only that the brewer in a sale to a Connecticut wholesaler not exceed its previously posted price in Connecticut, but that a sale at a price lower in a border state, during the calendar month covered by such posting, does not contravene this section.... To the extent ... that C.G.S. s 30-63a(b) is inconsistent with [Conn.Pub.Act 84-332], it must be considered impliedly repealed since the latest expression of the legislature controls. Thus under the new affirmation scheme an out-of-state shipper is free to lower any border state price below the previously affirmed Connecticut price.

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Affidavit of the Liquor Commission at 3-4.

FN10. For the importance of having definitive indications as to how any particular affirmation will be applied, see Brown-Forman Distillers v. N.Y. Liquor Auth., 106 S.Ct. 2080 (1986), wherein the majority laments that "we have no means of predicting how the [New York] Liquor Authority would" react to an application for a price reduction following posting, and chastises the dissenters for "indulging [in the] assumption that the Authority will be sensitive to Commerce Clause concerns." Id. at 2087, 2086 n.5. The dissent, in turn, expressed the view that the Liquor Authority, like any agency "charged with rectifying questionable applications of necessarily general rules," was entitled to a presumption of constitutionality "consistent with the respect due state administrative organs responsible for the operation of a state law whose constitutionality is challenged ...." Id. at 2089-90. The ambiguity presented in Brown-Forman was avoided by the Commission's ruling. It is to be commended.

FN11. The distinction drawn by the Court of Appeals between milk and liquor may not be quite as sharp following the Supreme Court's decision in Brown-Forman in which the Court relied heavily on Seelig in overturning New York's affirmation statute.

FN12. The Supreme Court is currently divided as to how extensively the twenty-first amendment was intended to authorize state regulation of the liquor industry. Compare the opinion of the Court, (Powell, J.), in 324 Liquor Corp., 107 S.Ct. at 726 (the "States' Twenty-first Amendment powers, though broad, are circumscribed by other provisions of the Constitution"), with the dissent, (O'Connor, J.), id. at 730 (endorsing former Justice Black's view "that the Senators who approved the Twenty-first Amendment thought they were returning absolute control over the liquor industry to the States"). See also Newport v. Iacobucci, 107 S.Ct. 383 (1986); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984).

FN13. From the late nineteenth century until the New Deal, the commerce clause was used--often in conjunction with the due process clause of the fourteenth amendment--to invalidate numerous state regulatory measures. See, e.g., Seelig. From 1945 to 1970 the commerce clause was invoked rarely--and the due process clause hardly at all--to strike down economic legislation. In the last decade, the Supreme Court increasingly entertained objections to state statutes based on the burdens imposed on interstate commerce. See, e.g., New England Power Co. v. New Hampshire, 455 U.S. 331 (1982).

FN14. On this point, see the district court opinion in Healy I, 532 F.Supp. at 1318 n.16, 1323 n.41.

FN15. Statutes, such as Connecticut's, enacted in several states, though overlapping, are unlikely to conflict, but, as pointed to prices at the lowest common denominator, are more likely to produce harmony, i.e., uniform low prices.

D.Conn.,1987.

UNITED STATES BREWERS ASSOCIATION, et al. v. John T. **HEALY**, et al.
--- F.Supp. ----, No. CIV H-84-816 (PCD)
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UNITED STATES BREWERS ASSOCIATION, INC., et al., Plaintiffs-Appellants,

v.

John F. HEALY, et al., Defendants-Appellees.

No. 994, Docket 82-7158.

United States Court of Appeals,
Second Circuit.

Argued May 19, 1982.

Decided Nov. 1, 1982.

Nonprofit corporation representing brewers and importers of beer, and brewers and importers of beer appealed from a final judgment of the United States District Court for the District of Connecticut, 532 F.Supp. 1312, M. Joseph Blumenfeld, J., which dismissed their complaint against officials of the Connecticut Liquor Control Department seeking declaratory and injunctive relief to prohibit enforcement of the beer price affirmation provisions of the Connecticut Liquor Control Act. The Court of Appeals, Kearse, Circuit Judge, held that beer price affirmation provisions of Connecticut Liquor Control Act, which prevented brewers from selling below the Connecticut wholesaler price to any wholesaler in any neighboring state, placed an unconstitutional burden on interstate commerce; nothing in Twenty-First Amendment permitted Connecticut to set the minimum prices for the sale of beer in any other state.

Reversed and remanded.

1. Commerce 🔑54

State regulation that is designed to confer economic benefits on the businesses and residents of the state, and does so at expense of businesses and residents of other states, is generally impermissible under commerce clause. U.S.C.A. Const. Art. 1, § 8, cl. 3.

2. Commerce 🔑48

If state regulation does not seek to distinguish between articles of commerce on basis of their domestic or out-of-state origins, and effects on interstate commerce are only incidental, state regulation will be found to burden commerce impermissibly only if, on balance, benefits sought by regulating state outweigh the detriments to interstate commerce. U.S.C.A. Const. Art. 1, § 8, cl. 3.

3. Intoxicating Liquors 🔑6

Twenty-First Amendment gives states broad powers to ban, restrict, or otherwise regulate importation and in-state traffic in alcoholic beverages. U.S.C.A. Const. Amend. 21.

4. Commerce 🔑74.35

Twenty-First Amendment does not permit a state to regulate the sale of liquor outside of its own territory. U.S.C.A. Const.Amend. 21.

5. Commerce 🔑74.30

Intoxicating Liquors 🔑6

Beer price affirmation provisions of Connecticut Liquor Control Act, which prevented a brewer from selling below the Connecticut wholesaler price to any wholesaler in any neighboring state, placed an unconstitutional burden on interstate commerce; nothing in Twenty-First Amendment permitted Connecticut to set the minimum prices for the sale of beer in any other state. U.S.C.A. Const. Art. 1, § 8, cl. 3; Amend. 21; C.G.S.A. §§ 30-63a(b), 30-63b(b), 30-63c(b).

William H. Allen, Washington, D.C. (H. Thomas Austern, Richard A. Friedman, Sarah E. Burns, Covington & Burling, Washington, D.C., Winthrop J. Allegaert, Thomas J. Sheridan, III, Richards, O'Neil & Allegaert, New York City, on brief), for plaintiffs-appellants U.S. Brewers Ass'n, et al.

William Hughes Mulligan, New York City (John D. Feerick, Jeffrey Glekel, Charles M. Yablon, Timothy G. Reynolds, Skadden, Arps, Slate, Meagher & Flom, New York City, Day, Berry & Howard, Hartford, Conn., of counsel), for plaintiff-appellant Anheuser-Busch, Inc.

John R. Lacey, Asst. Atty. Gen., Hartford, Conn., Richard M. Sheridan, Asst. Atty. Gen., Newington, Conn. (Carl R. Ajello, Atty. Gen. of the State of Conn., Robert M. Langer, Asst. Atty. Gen., Hartford, Conn., Robert F. Vacchelli, Asst. Atty. Gen., Newington, Conn.), for defendants-appellees John F. Healy, et al.

Before TIMBERS, VAN GRAAFEILAND, and KEARSE, Circuit Judges.

KEARSE, Circuit Judge:

Plaintiffs United States Brewers Association, a non-profit corporation representing brewers and importers of beer, and individual companies that are brewers or importers of beer, appeal from a final judgment of the United States District Court for the District of Connecticut, M. Joseph Blumenfeld, *Judge*, dismissing their complaint against defendants John F. Healy, *et al.*, officials of the Connecticut Liquor Control Department, seeking declaratory and injunctive relief to prohibit the enforcement of §§ 30–63a(b), 30–63b(b), and 30–63c(b) (the "beer price affirmation" provisions or "Connecticut statute") of the Connecticut Liquor Control Act, Conn.Gen.Stat.Ann. §§ 30–1 to 30–113 (West 1975 & Supp. 1982). Plaintiffs contended principally that the beer price affirmation provisions violate the Supremacy Clause of the Constitution, art. VI, cl. 2, by requiring them to violate § 1 of the Sherman Act, 15 U.S.C. § 1 (1976), and place an impermissible burden on interstate commerce in violation of the Commerce Clause of the Constitution, art. I, § 8, cl. 3. In an opinion reported at 532 F.Supp. 1312 (1982), the district court granted summary judgment in favor of defendants. Since we conclude that the Connecticut statute places an unconstitutional burden on interstate commerce, we reverse.

I. FACTS

The Connecticut Liquor Control Act is a comprehensive statute regulating the sale and distribution of liquor in Connecticut. Historically the retail price of beer has been generally higher in Connecticut than in its neighboring states, *i.e.*, Massachusetts, New York, and Rhode Island. As a consequence Connecticut residents have crossed state borders in significant numbers to purchase beer in other states at lower retail prices. In 1981, the Connecticut legislature amended the Liquor Control Act, effective January 1, 1982, by enacting the beer price affirmation provisions challenged here. The district court found it undisputed that the purpose of these provisions was to lower the retail price of beer in Connecticut, thereby increasing the purchase of beer by Connecticut residents within the state and generating increased tax revenues for the state. 532 F.Supp. at 1316–17.

Several provisions were adopted to achieve these goals. Conn.Gen.Stat. § 30–63(c) provides, as it did before the 1981 amendments, that each manufacturer or importer of beer (collectively "brewers")[1] must file a schedule stating the per-unit[2] price that it will charge Connecticut wholesalers for its products in the following month.[3] These "posted prices" must be

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[1] The statute, *see* notes 3, 5, 6, and 7 *infra*, refers to "manufacturers" and "out-of-state shipper" permittees. There are no breweries in Connecticut, and the beer price affirmation provisions hence impose requirements only on out-of-state companies.

[2] Prices are to be posted per bottle, per can, and per case for every size container. We use the term "per unit" to encompass all of these.

[3] Section 30–63(c) (West Supp.1982) provides, in pertinent part, as follows:

> Each manufacturer, wholesaler and out-of-state shipper permittee shall post with the department the bottle, can and case price of any brand of goods offered for sale in Connecticut, which price when so posted shall be the controlling price for such manufacturer, wholesaler or out-of-state permittee for the month following such posting.... A manufacturer or wholesaler may amend his posted price for any month to meet a lower price posted by another manufacturer or wholesaler with respect to alcoholic liquor bearing the same brand or trade name and of like age, vintage, quality and unit container size; provided that any such amended price posting shall be filed before three o'clock P.M. of the fourth business day after the last day for

filed on the thirteenth day of the prior month, Conn. Dep't of Liquor Regs. § 30–6–B4; and § 30–63(c) as amended in 1981 provides that the posted prices may not be changed, except that within the four-day period following the posting deadline a manufacturer or wholesaler may lower its posted price to meet, but not to beat, the lower posted price of another manufacturer or wholesaler with respect to a beer of like grade and quality. A brewer is not permitted to deviate from its posted prices in selling to Connecticut wholesalers during the one-month period to which the posting applies. *Id.*

Conn.Gen.Stat. § 30–63b(b) was added to require that when the brewer posts its prices pursuant to § 30–63(c), it must also file a sworn affirmation that its posted per-unit prices will be no higher than its prices for the corresponding units sold[4] in any state bordering Connecticut during the month covered by the posting.[5] In the same vein, § 30–63a(b) was added to prohibit a brewer from selling beer to a Connecticut wholesaler at a unit price higher than the lowest price charged for that unit by the brewer in any state bordering Connecticut.[6]

Finally, new § 30–63c(b) provides that a brewer's "lowest" price to a wholesaler in a neighboring state is to be determined by taking into account adjustments for rebates, discounts, allowances, and other inducements of any kind offered to the out-of-state wholesaler; and it requires each brewer to offer to Connecticut wholesalers all of the same sizes of its brand that are offered in the bordering states.[7] For a

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> posting prices; and provided further such amended posting shall not set forth prices lower than those being met.

The portion of the section preceding the ellipsis was part of the Liquor Control Act prior to the 1981 amendments; the portion following the ellipsis was added in 1981.

[4] The statute, *see, e.g.*, note 5 *infra*, refers to shipment, transport, delivery, sale, etc. For convenience we use the term "sale" to encompass all of these.

[5] Section 30–63b(b) (West Supp.1982) provides as follows:

> At the time of posting of the bottle, can and case price required by section 30–63, every holder of a manufacturer or out-of-state shipper's permit, or the authorized representative of a manufacturer, shall file with the department of liquor control a written affirmation under oath by the manufacturer or out-of-state shipper of each brand of beer posted certifying that the bottle, can or case price to the wholesaler permittees during the period of the posting will be no higher than the lowest price at which each such item of beer is or will be sold, offered for sale, shipped, transported or delivered by such manufacturer or out-of-state shipper to any wholesaler in any state bordering this state, at any time during the calender month covered by such posting.

[6] Section 30–63a(b) (West Supp.1982) provides as follows:

> No holder of any manufacturer or out-of-state shipper's permit shall ship, transport or deliver within this state, or sell or offer for sale to a wholesaler permittee any brand of beer as defined in section 30–1, at a bottle, can or case price higher than the lowest price at which such item is then being sold or offered for sale or shipped, transported or delivered by such manufacturer or out-of-state shipper to any wholesaler in any state bordering this state.

[7] Section 30–63c(b) (West Supp.1982) provides as follows:

> In determining the lowest price for which any item of beer is or was sold, offered for sale, shipped, transported or delivered during such posted period by any manufacturer or out-of-state shipper to a wholesaler in any state bordering this state, appropriate reductions will be made for all discounts, rebates, free goods, allowances and other inducements of any kind whatsoever, including depletion and floor-stock allowances, offered or given to any such wholesaler; provided that differentials in price which make only due allowance for differences in state taxes and fees and for the actual cost of delivery are permissible. As used in this section, the term "state taxes and fees" shall mean the excise taxes imposed or the fees required by any state or the District of Columbia upon or based upon a gallon or liter of such alcohol and spirits or each barrel, or fractional unit thereof, of beer and the term "gallon" shall mean one hundred twenty-eight fluid ounces and the term "liter" shall mean one thousand milliliters and the term "barrel" means not less than twenty-eight nor more than thirty-one gallons. A manufacturer or out-of-state shipper of beer shall offer to Connecticut wholesalers all of the sizes, approved by the department of liquor control, of his brand which he offers to any wholesaler in any state bordering this state.

violation of these provisions a brewer may have its permit to do business in Connecticut revoked or suspended, Conn.Gen.Stat. Ann. § 30–57 (West Supp.1982), or may be fined $1000 and/or imprisoned for up to one year, Conn.Gen.Stat.Ann. § 30–113 (West Supp.1982).

Plaintiffs commenced the present action seeking declaratory and injunctive relief prohibiting the enforcement against them of the beer price affirmation provisions, contending that the Connecticut statute is unconstitutional in two principal respects.[8] First, plaintiffs argued that the beer price affirmation provisions require industry-wide conduct tantamount to the fixing of minimum prices, which would violate § 1 of the Sherman Act, 15 U.S.C. § 1, if undertaken voluntarily by private parties. They contended that the Connecticut provisions are thus preempted by the Sherman Act, and that the enforcement of the state provisions would violate the Supremacy Clause of the Constitution. Second, plaintiffs contended that the Connecticut statute is protectionist legislation that impermissibly burdens interstate commerce and discriminates against out-of-state businesses in violation of the Commerce Clause. Defendants, on the other hand, contended that the Twenty-first Amendment to the Constitution gives the state carte blanche to regulate the prices at which plaintiffs may sell beer in Connecticut and that, accordingly, plaintiffs' claims must fail. Both sides moved for summary judgment.

The district court granted defendants' motion and dismissed the complaint. The court held that the beer price affirmation statute does not violate the Supremacy Clause because it does not require brewers to enter into a contract, combination, or conspiracy in violation of the Sherman Act. 532 F.Supp. at 1328–30. The court rejected plaintiffs' Commerce Clause claims on the grounds that the legislation is not impermissibly protectionist or discriminatory in intent because it attempts only to equalize, not to favor, the competitive position of Connecticut dealers, *id.* at 1323; that the statute has no discriminatory effect because out-of-state wholesalers have "no right, constitutional or otherwise, to receive lower prices from the brewers," *id.* at 1324; and, relying on *Joseph E. Seagram & Sons v. Hostetter,* 384 U.S. 35, 86 S.Ct. 1254, 16 L.Ed.2d 336 (1966), that the statute does not place an undue burden on commerce, 532 F.Supp. at 1324–27.

On appeal, plaintiffs pursue their Supremacy Clause and Commerce Clause claims.[9] For the reasons below, we conclude that the Connecticut statute is permitted by neither the Commerce Clause nor the Twenty-first Amendment, and we reverse the judgment on that ground without reaching plaintiffs' Supremacy Clause contentions.

II. DISCUSSION

The Commerce Clause of the Constitution provides that "Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States . . . ." U.S.Const. art. I, § 8, cl. 3. This grant of authority to Congress has long been construed to place implicit limitations on actions affecting interstate commerce that may be taken by individual states. *See, e.g., Cooley v. Board of Wardens,* 53 U.S. (12 How.) 299, 13 L.Ed. 996 (1851); *The Passenger Cases,* 48 U.S. (7 How.) 282, 12 L.Ed. 72 (1849). In general the Commerce Clause is viewed as intending to promote free trade among the states and to liberate the flow of articles in commerce from the provincialism evident in many local regulations. *See, e.g., Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 522, 55 S.Ct. 497, 500, 79 L.Ed. 1032 (1935).

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[8] The action was commenced prior to the effective date of the amendments and plaintiffs unsuccessfully sought a preliminary injunction against enforcement.

[9] In the district court plaintiffs contended also that the Connecticut statute violated their rights to substantive due process and infringed on the powers of Massachusetts, New York, and Rhode Island under the Twenty-first Amendment to regulate the sale of beer within their respective borders. Plaintiffs do not pursue these arguments on appeal.

A. *General Commerce Clause Principles*

[1, 2] With these goals in mind several general precepts regarding the Commerce Clause have been formulated. State regulation that is designed to confer economic benefits on the businesses and residents of the state, and to do so at the expense of businesses and residents of other states, is generally impermissible. *See, e.g., Hunt v. Washington State Apple Advertising Commission,* 432 U.S. 333, 350–53, 97 S.Ct. 2434, 2445–2446, 53 L.Ed.2d 383 (1977). Such discriminatory regulation constitutes "simple economic protectionism," which is "virtually *per se*" unconstitutional. *City of Philadelphia v. New Jersey,* 437 U.S. 617, 624, 98 S.Ct. 2531, 2535, 57 L.Ed.2d 475 (1978) (state prohibition of use of local landfills for garbage of out-of-state origin violates Commerce Clause).

If, on the other hand, the state regulation does not seek to distinguish between articles of commerce on the basis of their domestic or out-of-state origins, and the effects on interstate commerce are only incidental, the regulation will be found to burden commerce impermissibly only if, on balance, the benefits sought by the regulating state outweigh the detriments to interstate commerce. *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970); *Lewis v. BT Investment Managers, Inc.,* 447 U.S. 27, 36–37, 100 S.Ct. 2009, 2015–2016, 64 L.Ed.2d 702 (1980); *Hughes v. Oklahoma,* 441 U.S. 322, 331, 99 S.Ct. 1727, 1733, 60 L.Ed.2d 250 (1979). In *Pike v. Bruce Church,* the Supreme Court stated this principle as follows:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.... If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.

397 U.S. at 142, 90 S.Ct. at 847 (citation omitted). Where the local interest involved could plainly have been promoted with a lesser impact on interstate activities, the state regulation has been held to violate the Commerce Clause. *E.g., Great Atlantic & Pacific Tea Co. v. Cottrell,* 424 U.S. 366, 96 S.Ct. 923, 47 L.Ed.2d 55 (1976) (where local inspections could serve purpose of ensuring that local health standards were met, statute permitting sale of out-of-state milk in Mississippi only if the state of origin allowed sale therein of Mississippi milk on a reciprocal basis impermissibly burdened commerce).

If the purpose or effect of a state's law is to regulate conduct occurring wholly outside the state, the burden on commerce is generally held impermissible, and the fact that the law may not have been intended as protectionist or discriminatory will not save it. In *Shafer v. Farmers Grain Co.,* 268 U.S. 189, 199, 45 S.Ct. 481, 485, 69 L.Ed. 909 (1925), the Court stated that "a state statute which by its necessary operation directly interferes with or burdens such commerce is a prohibited regulation and invalid, regardless of the purpose with which it was enacted." Thus, it has been held repeatedly that where the practical effect of a state's legislation is to control conduct in *other* states, the regulation violates the Commerce Clause. *E.g., New York, Lake Erie & Western Railroad v. Pennsylvania,* 153 U.S. 628, 646, 14 S.Ct. 952, 958, 38 L.Ed. 846 (1894) (state may not constitutionally regulate payments made by railroad in another state); *Shafer v. Farmers Grain Co., supra,* 268 U.S. at 201, 45 S.Ct. at 486 (regulation of in-state purchases with a view to preventing "unreasonable margins of profit" on out-of-state resales violates Commerce Clause); *Fidelity & Deposit Co. v. Tafoya,* 270 U.S. 426, 435, 46 S.Ct. 331, 332, 70 L.Ed. 664 (1926) (state may not prevent corporation from employing and paying out-of-state agents needed for its in-state business); *Baldwin v. G.A.F. Seelig, Inc., supra,* 294 U.S. at 524, 528, 55 S.Ct. at 500, 502 (interstate commerce unduly burdened by state law forbidding in-state resale of milk purchased from out-of-state farmers at prices below the minimum prices required to be paid to in-state farmers); *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 775, 65 S.Ct. 1515, 1523, 89 L.Ed. 1915 (1945) (state may not regulate length of trains within its territory where "practical effect ... is to control train operations beyond [its] boundaries ... because of the necessity of breaking up and reassembling long trains at the nearest terminal points before entering and after leaving the regulating state"); *see also Edgar v. Mite Corp.*, — U.S. —, 102 S.Ct. 2629, 2641, 73 L.Ed.2d 269 (1982) (opinion of White, J.) ("Commerce Clause ... precludes the application of a state statute to commerce that takes place wholly outside of the state's borders, whether or not the commerce has effects within the state").

In *Edgar v. Mite Corp.*, the Supreme Court dealt with an Illinois statute that regulated tender offers for corporations at least 10% of whose securities subject to the offer were owned by shareholders located in Illinois. The Court observed that the statute would interfere with the rights of non-Illinois shareholders to sell their shares to a non-Illinois buyer in a transaction outside of Illinois, and concluded that even applying the balancing test set forth in *Pike v. Bruce Church, Inc., supra*, the extraterritorial effect of the statute far outweighed its in-state benefits:

> The most obvious burden the Illinois Act imposes on interstate commerce arises from the statute's previously-described nationwide reach which purports to give Illinois the power to determine whether a tender offer may proceed anywhere.
>
> ....
>
> While protecting local investors is plainly a legitimate state objective, the state has no legitimate interest in protecting non-resident shareholders. Insofar as the Illinois law burdens out-of-state transactions, there is nothing to be weighed in the balance to sustain the law.

Id. at 2641–42.[10]

B. *Principles Governing Commerce in Alcoholic Beverages*

[3] To an extent, the limitations placed by the Commerce Clause upon the powers of individual states to regulate commerce have been altered with respect to alcoholic beverages by the Twenty-first Amendment to the Constitution. Section 2 of that Amendment provides as follows:

> The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

The Twenty-first Amendment thus gives the states broad power to ban, restrict, or otherwise regulate importation and in-state traffic in alcoholic beverages, and thereby eliminates some of the otherwise applicable Commerce Clause constraints. *See Joseph E. Seagram & Sons v. Hostetter, supra*, 384 U.S. at 42, 86 S.Ct. at 1259. For example, a state may prohibit entirely the sale of intoxicating liquors within its borders, *see State Board of Equalization v. Young's Market Co.*, 299 U.S. 59, 62–63, 57 S.Ct. 77, 78–79, 81 L.Ed. 38 (1936), although under traditional Commerce Clause limitations it could not ban the sale of other products, *see, e.g., Baldwin v. G.A.F. Seelig, Inc., supra*, 294 U.S. at 521, 55 S.Ct. at 499 (wholesome milk); *Railroad Co. v. Husen*, 95 U.S. 465, 24 L.Ed. 556 (1877) (healthy cattle). Or a state may prohibit local dealers from selling beer manufactured in another state on the ground that the latter state discriminates against beer manufactured in the first state, *see Indianapolis Brewing Co. v. Liquor Control Commission,* 305 U.S. 391, 59 S.Ct. 254, 83 L.Ed. 243 (1939), although it would not be free to impose the same type of restrictions with respect to milk, *see Great Atlantic & Pacific Tea Co. v. Cottrell, supra;* nor could it constitutionally prohibit the exportation of local ground water to another state on the basis that the latter state would forbid exportation of its water to the first state, *see Sporhase v. Nebraska,* —— U.S. ——, 102 S.Ct. 3456, 73 L.Ed.2d 1254 (1982).

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[10] *See also id.* at 2641 (opinion of White, J.): The limits on a state's power to enact substantive legislation are similar to the limits on the jurisdiction of state courts. In either case, "any attempt 'directly' to assert extraterritorial jurisdiction over persons or property would offend sister States and exceed the inherent limits of the State's power." *Shaffer v. Heitner*, 433 U.S. 186, 197, 97 S.Ct. 2569, 2576, 53 L.Ed.2d 683 (1977).

Because the Illinois Act purports to regulate directly and to interdict interstate commerce, including commerce wholly outside the state, it must be held invalid as were the laws at issue in *Shaffer* and [*Southern Pacific Co. v. Arizona, supra*].

[4] Notwithstanding the greater scope permitted to the states for regulation of traffic in intoxicating beverages, nothing in the Twenty-first Amendment suggests that a state may regulate the sale of liquor outside of its own territory. The Amendment itself speaks only of the "transportation or importation *into* any State . . . for delivery or use *therein.*" (Emphasis added.) Nor do the cases interpreting the Amendment indicate that the Amendment, any more than the Commerce Clause, allows a state to regulate liquor traffic outside its territory. Thus, the Supreme Court has noted that "the second section of the Twenty-first Amendment has not operated totally to repeal the Commerce Clause in the area of the regulation of traffic in liquor," *Joseph E. Seagram & Sons v. Hostetter, supra,* 384 U.S. at 42, 86 S.Ct. at 1259, and has indicated that the traditional Commerce Clause strictures are inapplicable only " 'when [the state] restricts the importation of intoxicants destined for use, distribution, or consumption *within its borders,*' " *id.* (emphasis added) (quoting *Hostetter v. Idlewild Bon Voyage Liquor Corp.,* 377 U.S. 324, 330, 84 S.Ct. 1293, 1296, 12 L.Ed.2d 350 (1964)). Accordingly, the Court has held it impermissible for a state to prevent shipment into and through its territory of liquor destined for distribution and consumption in a national park, an area not within the state's governance, *Collins v. Yosemite Park & Curry Co.,* 304 U.S. 518, 58 S.Ct. 1009, 82 L.Ed. 1502 (1938), or of liquor destined for ultimate delivery and use in a foreign country, *Hostetter v. Idlewild Bon Voyage Liquor Corp., supra.* We are aware of no authority to the effect that the Twenty-first Amendment modifies the traditional Commerce Clause principles that bar a state from regulating the transport, sale, or use of products outside of its own territory.

C. *Applicability of Commerce Clause and Twenty-first Amendment Principles to Connecticut's Beer Price Affirmation Provisions*

[5] Plaintiffs have launched an all-out attack on the Connecticut beer price affirmation provisions under the Commerce Clause, contending, *inter alia,* that the statute was enacted with a discriminatory purpose,[11] that it will have a discriminatory effect,[12] that it burdens interstate com-

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[11] Plaintiffs argue that the purpose of the statute was to protect local wholesalers and retailers from competition with out-of-state wholesalers and retailers. (*See* Anheuser-Busch brief on appeal at 8.) The district court found this contention unsupported by the record. 532 F.Supp. at 1318 n.16, 1323.

[12] The district court rejected the contention that the legislation had a discriminatory effect, stating as follows:

> Plaintiffs argue that regardless of its purpose the statute has a discriminatory *effect* on out-of-state wholesalers and *retailers.* It is significant that the brewers here are attempting to invalidate the statute not because of its direct effects on them, but because of its indirect effects on third parties. They do not argue that the statute discriminates against out-of-state brewers or importers for the simple reason that there are no Connecticut brewers or importers. *See Exxon Corp. v. Governor of Maryland,* 437 U.S. 117, 125, 98 S.Ct. 2207, 2213, 57 L.Ed.2d 91 (1978).
>
> The brewers assert that the statute discriminates against out-of-state wholesalers and retailers. It is difficult, however, to conceive of the nature of the alleged discrimination. The statute does not affect any business out-of-state wholesalers or retailers conduct *in* Connecticut, since they are not permitted by law to sell beer within the state. Nor does the statute affect any rights to which out-of-state wholesalers or retailers are entitled. The brewers' argument, based on *Hunt v. Washington State Apple Advertising Comm'n,* 432 U.S. 333, 351–52, 97 S.Ct. 2434, 2445–2446, 53 L.Ed.2d 383 (1977), that the statute strips out-of-state retailers of a competitive advantage—lower prices—misses the point. Out-of-state wholesalers and

merce by restricting the movement of consumers across state lines,[13] and that the law is ill-suited to achieve Connecticut's goals.[14] We need reach none of these contentions, however, in order to find the beer price affirmation provisions on their face an impermissible burden on commerce, for it is evident that the Connecticut statute seeks to regulate prices not just in Connecticut but in its surrounding states as well.

Section 30–63(c), which requires the posting of prices to be charged to Connecticut wholesalers for the coming month, is not itself in issue, for, standing alone, it has no extraterritorial effect. But the extraterritorial thrust of the main beer price affirmation provisions, §§ 30–63a(b) and 30–63b(b), *see* notes 6 and 5 *supra*, is plain, for those sections prevent a brewer from selling below the Connecticut wholesaler price to any wholesaler in any neighboring state. In other words, these sections tell a brewer that for any given month when it sells beer to a wholesaler in Massachusetts, New York, or Rhode Island, it may not do so at a price lower than that it has previously announced it will charge to Connecticut wholesalers. As the district court succinctly described it,

> [b]ecause it is geared to the future, the Connecticut statute effectively sets minimum prices for the four-state area once the price is posted in Connecticut on the thirteenth of the month.

532 F.Supp. at 1329.[15]

Thus, the obvious effect of the Connecticut statute is to control the minimum price that may be charged by a non-Connecticut brewer to a non-Connecticut wholesaler in a sale outside of Connecticut. Nothing in the Twenty-first Amendment permits Connecticut to set the minimum prices for the sale of beer in any other state, and well-established Commerce Clause principles prohibit the state from controlling the prices set for sales occurring wholly outside its territory.

Defendants' reliance on *Joseph E. Seagram & Sons v. Hostetter*, *supra*, as sanctioning Connecticut's beer price affirmation provisions, is misplaced. In *Seagram*, the Court considered a New York law that re-

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> retailers are not entitled to receive prices lower than those charged to their Connecticut counterparts. The out-of-state wholesalers and retailers have not, and could not complain that the statute takes from them the advantage of lower prices, when they have no right to those prices in the first place. If Connecticut may constitutionally regulate the prices brewers charge to their wholesalers, then it would seem to follow that the brewers may not complain about the incidental effects on their out-of-state customers when those effects do not implicate constitutional rights. Since it is clear that out-of-state wholesalers and retailers have no right, constitutional or otherwise, to receive lower beer prices from the brewers, there is nothing about which the brewers may complain. I therefore hold that the beer price affirmation statute does not discriminate against out-of-state businesses and does not, in this respect, contravene the Commerce Clause.

532 F.Supp. at 1324 (footnote omitted; emphasis in original).

[13] The district court rejected this argument on the ground, among others, that

> [t]he statute may reduce the incentives for Connecticut consumers to drive out of state for purchases of beer, but it does not involuntarily restrict their movements. That consumers may, of their own free will, decide not to drive to bordering states to purchase beer can hardly be characterized as a burden on interstate commerce.

532 F.Supp. at 1328.

[14] Plaintiffs argue that the Connecticut statute is unlikely to have the desired effects of increasing tax revenues (United States Brewers Association reply brief on appeal at 5) and of reducing prices to consumers: "[n]othing in the new law or any other Connecticut law is designed to ensure that, if prices to Connecticut wholesalers are reduced as a result of beer price affirmation (by no means a certainty), the reduction will be passed along to retailers and ultimately to Connecticut consumers." (United States Brewers Association brief on appeal at 45.) The district court found it unnecessary to reach these issues because it found the law did not burden commerce. 532 F.2d at 1327 n.52. In any event we consider that these issues, like several others raised by plaintiffs, do not appear to be particularly appropriate for resolution in plaintiff's favor by summary judgment.

[15] The district court discussed this extraterritorial thrust of the Connecticut statute only in its analysis of plaintiffs' Supremacy Clause claims and does not appear to have focused on this aspect of the law in analyzing the effect on commerce.

quired liquor manufacturers to post monthly price schedules for sales of liquor in New York, with "an affirmation that 'the bottle and case price of liquor . . . is no higher than the lowest price' at which sales were made anywhere in the United States during the *preceding* month." 384 U.S. at 39–40, 86 S.Ct. at 1257–1258 (emphasis added). The New York statute differed significantly from the Connecticut statute, because, unlike Connecticut's beer price affirmation provisions which control brewers' future conduct in the states surrounding Connecticut, the New York law in *Seagram* merely required that New York prices reflect what had been charged elsewhere in the past. Thus, the New York law, although it affected the prices that manufacturers would choose to set in other states, did not limit the freedom of a manufacturer at any given time to raise or lower prices in any other state.

In ruling that the New York statute in *Seagram* did not violate the Commerce Clause, the Court stated as follows:

> We need not now decide whether the mode of liquor regulation chosen by a State in such circumstances could ever constitute so grave an interference with a company's operations elsewhere as to make the regulation invalid under the Commerce Clause. *See Baldwin v. G.A.F. Seelig,* 294 U.S. 511 [55 S.Ct. 497, 79 L.Ed. 1032]. No such situation is presented in this case. The mere fact that § 9 is geared to appellants' pricing policies in other States is not sufficient to invalidate the statute. As part of its regulatory scheme for the sale of liquor, New York may constitutionally insist that liquor prices to domestic wholesalers and retailers be as low as prices offered elsewhere in the country.

Id. at 42–43, 86 S.Ct. at 1259–1260 (footnote omitted). The Court had taken care to note that this New York law, unlike that invalidated in *Hostetter v. Idlewild Bon Voyage Liquor Corp., supra,* concerned liquor destined for use or distribution only "in the State of New York." *Id.* at 42, 86 S.Ct. at 1259.

We thus find in *Seagram* no indication that a state is permitted to control the prices at which liquor may be sold in other states, and we believe the *Seagram* Court's recognition that the New York statute regulated prices only within New York is highlighted by the Court's repeated references to *Baldwin v. G.A.F. Seelig, Inc.* The *Seagram* Court first cited *Seelig* in stating that there was no need in *Seagram* to decide whether the mode of liquor regulation within a state could "constitute so grave an interference with a company's operations elsewhere as to make the regulation invalid under the Commerce Clause." 384 U.S. at 42–43, 86 S.Ct. at 1259, 1260. In *Seelig,* the Court had held unconstitutional a New York statute that forbade the sale of Vermont-produced milk in New York unless the price paid to Vermont farmers was as high as the minimum price New York law required to be paid to New York farmers. Analysis in *Seelig* had commenced with the recognition that "New York has no power to project its legislation into Vermont by regulating the price to be paid in that state for milk acquired there." 294 U.S. at 521, 55 S.Ct. at 499. The *Seagram* Court's second citation to *Seelig* followed its observation that "'[t]he mere fact that state action may have repercussions beyond state lines is of no judicial significance so long as the action is not within that domain which the Constitution forbids.'" *Id.* at 43, 86 S.Ct. at 1260 (quoting *Osborn v. Ozlin,* 310 U.S. 53, 62, 60 S.Ct. 758, 761, 84 L.Ed. 1074 (1940)). The Court then cited *Seelig* and other cases, presumably to indicate what actions may be "within that domain which the Constitution forbids," and the page of the *Seelig* opinion to which the *Seagram* Court referred contains the statement that "[i]t is a very different thing to establish a . . . scale of prices for use in other states . . . ." 294 U.S. at 528, 55 S.Ct. at 502.

Given the latitude allowed a state under the Twenty-first Amendment to regulate the sale of liquor within its own borders, the holding in *Seagram* might well validate beer price regulation less intrusive than the present Connecticut statute, such as a requirement simply that a brewer set its Connecticut prices at the lowest levels it chooses to set in the surrounding states, *see* 384 U.S. at 43–45, 86 S.Ct. at 1260–1261, leaving those out-of-state prices unregulated by Connecticut. But nothing in *Seagram* purports to rule that a state may achieve its goal of price-parity by the far more drastic, and clearly excessive, method of controlling the minimum prices at which liquor may be sold outside of its own territory. We conclude that "[i]nsofar as the [Connecticut] statute burdens out-of-state transactions, there is nothing to be weighed in the balance to sustain the law." *Edgar v. Mite Corp., supra.*

CONCLUSION

The judgment is reversed and the case is remanded to the district court for entry of judgment, in accordance with this opinion, in favor of plaintiffs.

UNITED STATES of America, Appellee,

v.

Rafael Isivor PINEDA, Defendant-Appellant.

No. 249, Docket 82-1186.

United States Court of Appeals, Second Circuit.

Argued Sept. 2, 1982.

Decided Nov. 8, 1982.

Defendant, who was convicted on guilty plea to two counts of preparing and conspiring to prepare false documents for submission to government agency, appealed from a judgment of the United States District Court for the Southern District of New York, Charles S. Haight, Jr., J., sentencing him to four years' imprisonment and five years' probation. The Court of Appeals, Lumbard, Circuit Judge, held that conduct of officer for Immigration and Naturalization Service in recording conversation between defendant and former "customer," who had allegedly purchased fraudulent papers from defendant to help with application to obtain immigrant visa for relative, between defendant's guilty plea and sentencing hearing did not violate defendant's Sixth Amendment right to counsel, and there was no error in admission of recorded conversation at sentencing hearing.

Judgment affirmed.

1. Criminal Law ⇨641.12(2), 986.6(3)

Conduct of officer for Immigration and Naturalization Service in recording conversation between defendant and former "customer," who had allegedly purchased fraudulent papers from defendant to help with application to obtain immigrant visa for relative, between defendant's guilty plea and sentencing hearing did not violate defendant's Sixth Amendment right to counsel, and there was no error in admission of recorded conversation at sentencing hearing, where, in recording conversation, Government sought evidence of criminal conduct that occurred after indictment was filed, Government's continuing investigation into visa fraud was proper, and it was during course of legitimate investigation on defense counsel's request that Government produce witnesses who had purchased false papers from defendant that Government interviewed former "customer" and learned that, after pleading guilty, defendant had instructed her to lie to INS officials. 18 U.S.C.A. §§ 371, 1001; U.S.C.A. Const. Amend. 6.

2. Criminal Law ⇨641.12(1)

Ordinarily, Government's deliberate use of informer to elicit incriminating statements from defendant after indictment violates Sixth Amendment. U.S.C.A. Const. Amend. 6.

3. Criminal Law ⇨986.6(3)

Statements obtained in violation of Sixth Amendment are inadmissible against stances when the exigencies of the situation demand such relief, *Wetzel v. Edwards*, 635 F.2d 283 (4th Cir. 1980), the Court holds that plaintiffs' motion for a preliminary injunction is denied.

An appropriate order will issue.

UNITED STATES BREWERS ASSOCIATION, INC., et al.

v.

John F. HEALY, et al.

Civ. No. H-81-836.

United States District Court,
D. Connecticut.

Feb. 16, 1982.

Brewers association brought action challenging the constitutionality of Connecticut's beer price affirmation statute. On cross motions for summary judgment, the District Court, Blumenfeld, Senior District Judge, held that: (1) Connecticut's beer price affirmation statute, which required that brewers sell to Connecticut wholesalers at the lowest price that the same item was sold anywhere in four-state region, did not have a discriminatory purpose or effect nor impose an impermissible burden upon interstate commerce and therefore did not violate commerce clause; (2) Connecticut's beer price affirmation statute did not mandate conduct violative of Sherman Act so as to violate supremacy clause since it required only unilateral conduct by each brewer and importer; and (3) the statute did not impermissibly infringe on Twenty-First Amendment powers of the bordering states.

Plaintiffs' motion denied; defendants' cross motion granted.

1. Federal Civil Procedure ⇨2470.1

For summary judgment purposes, a material fact is one which may affect outcome of the litigation or which constitutes a legal defense to an action.

2. Federal Civil Procedure ⇨2534

Court does not assume that no material facts remain in dispute where both parties move for summary judgment; rather, court must evaluate each party's motion on its own merits to determine if summary disposition is appropriate.

3. Federal Civil Procedure ⇨2470.1

Even genuine disputed issues of fact will not preclude summary judgment unless they are material to the legal issues in the case.

4. Constitutional Law ⇨48(4)

State statutes regulating alcoholic beverages are entitled to a presumption of validity in light of broad scope of power in that area. U.S.C.A.Const.Amend. 21.

5. Commerce ⇨74.30

Second section of Twenty-First Amendment has not operated totally to repeal commerce clause in area of the relation of traffic in liquor. U.S.C.A.Const.Art. 1, § 8, cl. 3; Amend. 21.

6. Commerce ⇨74.30

Connecticut's beer price affirmation statute, which required that brewers sell to Connecticut wholesalers at the lowest price that the same item was sold anywhere in four-state region, did not have a discriminatory purpose or effect nor impose an impermissible burden upon interstate commerce and therefore did not violate commerce clause. C.G.S.A. §§ 30–63a(b), 30–63b(b), 30–63c(b); U.S.C.A.Const.Art. 1, § 8, cl. 3.

7. Commerce 🔑48

Withdrawal from a particular market is not necessarily a burden on commerce.

8. Federal Civil Procedure 🔑103

Brewers association did not have standing to challenge Connecticut's beer price affirmation statute on grounds that statute burdened interstate commerce by restricting the movement of consumers across state lines. C.G.S.A. §§ 30–63a(b), 30–63b(b), 30–63c(b); U.S.C.A.Const.Art. 1, § 8, cl. 3.

9. Federal Civil Procedure 🔑103

A plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on legal rights or interest of third parties.

10. Commerce 🔑48

Not everything which affects movement of persons is a burden on interstate commerce; the restriction must prevent or limit the exercise of right to freedom of movement to rise to level of a commerce clause violation. U.S.C.A.Const.Art. 1, § 8, cl. 3.

11. Commerce 🔑48

A statute which creates disincentives to travel across state lines by imposing costs on those who wish to do so can be characterized as a burden on interstate commerce. U.S.C.A.Const.Art. 1, § 8, cl. 3.

12. Commerce 🔑74.30

Connecticut's beer price affirmation statute, which encouraged consumers to voluntarily restrict their out-of-state purchases of beer, was not a burden on interstate commerce. C.G.S.A. §§ 30–63a(b), 30–63b(b), 30–63c(b); U.S.C.A.Const.Art. 1, § 8, cl. 3.

13. Intoxicating Liquors 🔑15
States 🔑4.13

Connecticut's beer price affirmation statute, which required that brewers sell to Connecticut wholesalers at the lowest price that the same item was sold anywhere in four-state region, did not mandate conduct violative of Sherman Act so as to violate supremacy clause since it required only unilateral conduct by each brewer and importer. C.G.S.A. §§ 30–63a(b), 30–63b(b), 30–63c(b); U.S.C.A.Const.Art. 6, cl. 2; Sherman Anti-Trust Act, § 1 et seq., 15 U.S.C.A. § 1 et seq.

14. Monopolies 🔑12(1.16)

Absent an agreement among private parties, there can be no violation of section of Sherman Act prohibiting contracts, combinations or conspiracies in restraint of trade. Sherman Anti-Trust Act, § 1 et seq., 15 U.S.C.A. § 1 et seq.

15. Constitutional Law 🔑298(1)
Intoxicating Liquors 🔑15

Connecticut's beer price affirmation statute, which required that brewers sell to Connecticut wholesalers at the lowest price that the same item was sold in four-state region, did not violate due process. C.G.S.A. §§ 30–63a(b), 30–63b(b), 30–63c(b); U.S.C.A.Const.Amend. 14.

16. Federal Civil Procedure 🔑103

Brewers association did not have standing to challenge the Connecticut's beer price affirmation statute on grounds that it impermissibly infringed on Twenty-First Amendment powers of bordering states. C.G.S.A. §§ 30–63a(b), 30–63b(b), 30–63c(b); U.S.C.A.Const.Amend. 21.

17. Intoxicating Liquors 🔑15

Connecticut's beer price affirmation statute which required that brewers sell to Connecticut wholesalers at the lowest price that the same item was sold anywhere in four-state region, did not impermissibly infringe on Twenty-First Amendment powers of bordering states. C.G.S.A. §§ 30–63a(b), 30–63b(b), 30–63c(b); U.S.C.A.Const. Amend. 21.

Henry L. Fisher, Lieberman & Segaloff, New Haven, Conn., William H. Allen, Richard A. Friedman, H. Thomas Austern, Sarah E. Burns, Covington & Burling, Washington, D. C., Richard M. Reynolds, Ralph C. Dixon, Day, Berry & Howard, Hartford, Conn., William H. Mulligan, Skadden, Arps, Slate, Meagher & Flom, New York City, for plaintiffs.

Carl Ajello, Atty. Gen., State of Conn., Robert Langer, John R. Lacey, Asst. Attys. Gen., Hartford, Conn., Richard M. Sheridan, Robert Vacchelli, Asst. Attys. Gen., Newington, Conn., for defendants.

RULING ON CROSS-MOTIONS FOR SUMMARY JUDGMENT

BLUMENFELD, Senior District Judge.

[1] Plaintiff, United States Brewers Association,[1] brings this action challenging the constitutionality of sections 30–63a(b),[2] 30–63b(b)[3] and 30–63c(b)[4] of the Connecticut Liquor Control Act, Connecticut General Statutes, Title 30, Ch. 545, as amended by Public Act No. 81–294, June 8, 1981 (hereafter referred to as the "beer price affirmation act," "the statute," or "the Act"). Plaintiff is a non-profit corporation representing brewers and importers of beer, many of whom sell beer in Connecticut and the three bordering states, New York, Massachusetts, and Rhode Island. Plaintiffs request a declaratory judgment holding these sections of the price affirmation statute unconstitutional as applied to them on the grounds that the Act violates the Supremacy Clause (art. VI, cl. 2) and the Commerce Clause (art. I, § 8, cl. 3) of the United States Constitution.[5] In addition, plaintiffs seek a permanent injunction restraining the

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[1] In addition to the United States Brewers Association (USBA), there are several other plaintiffs, all brewers and importers of beer. Only Anheuser-Busch, Inc. has appeared separately and filed its own motions and briefs. All parties join in USBA's motion for summary judgment, and for convenience I will refer to them collectively as plaintiff(s) or brewers.

[2] Liquor Control Act (LCA) Conn.Gen.Stat. § 30–63a(b), as added by Section 11 of Public Act No. 81–294, provides as follows:

> No holder of any manufacturer or out-of-state shipper's permit shall ship, transport or deliver within this state, or sell or offer for sale to a wholesaler permittee any brand of beer as defined in Section 30–1, at a bottle, can or case price higher than the lowest price at which such item is then being sold or offered for sale or shipped, transported or delivered by such manufacturer or out-of-state shipper to any wholesaler in any state bordering this state.

[3] LCA § 30–63b(b), as added by Section 12 of Public Act No. 81–294, provides as follows:

> At the time of posting of the bottle, can and case price required by Section 30–63, as amended by Section 10 of this act, every holder of a manufacturer or out-of-state shipper's permit, or the authorized representative of a manufacturer, shall file with the Department of Liquor Control a written affirmation under oath by the manufacturer or out-of-state shipper of each brand of beer posted certifying that the bottle, can or case price to the wholesaler permittees during the period of the posting will be no higher than the lowest price at which each such item of beer is or will be sold, offered for sale, shipped, transported or delivered by such manufacturer or out-of-state shipper to any wholesaler in any state bordering this state, at any time during the calendar month covered by such posting.

[4] LCA § 30–63c(b), as amended by Section 13 of Public Act No. 81–294, provides as follows:

> In determining the lowest price for which any item of beer is or was sold, offered for sale, shipped, transported or delivered during such posted period by any manufacturer or out-of-state shipper to a wholesaler in any state bordering this state, appropriate reductions will be made for all discounts, rebates, free goods, allowances and other inducements of any kind whatsoever, including depletion and floor-stock allowances, offered or given to any such wholesaler; provided that differentials in price which make only due allowance for differences in state taxes and fees and for the actual cost of delivery are permissible.... A manufacturer or out-of-state shipper of beer shall offer to Connecticut wholesalers all of the sizes, approved by the Division of Liquor Control, of his brand which he offers to any wholesaler in any state bordering this state.

[5] Plaintiffs also present claims under the Due Process Clause and the twenty-first amendment. These secondary claims will be dealt with later in this opinion. *See infra* at 1321, 1330–1331.

defendants, the members of the Department of Liquor Control of the State of Connecticut, from enforcing the provisions of the statute.[6] Jurisdiction in this court is based on 28 U.S.C. § 1331(a) which provides for federal court jurisdiction over civil actions arising under the laws or Constitution of the United States, and 28 U.S.C. § 1337 which confers jurisdiction over any civil action arising under any act of Congress regulating commerce.

The plaintiffs have submitted affidavits from seven brewers and six importers outlining the structure of the beer market in general and in the four-state market in particular. The affidavits outline the possible effects of the beer price affirmation statute on the brewers' business, and indicate the variety of responses open to the brewers. Plaintiffs have also submitted an affidavit of Dr. Bruce Owen, an economist, supporting their position that the statute will have anticompetitive effects on the beer industry in the four-state area. On November 10, 1981, a hearing on plaintiffs' motion for preliminary injunction was held. Subsequently, in a ruling dated November 25, 1981, the court denied the motion for a temporary injunction, finding that plaintiffs had failed to demonstrate either irreparable injury or a likelihood of success on the merits. *United States Brewers Association v. Healy*, Civil No. H-81-836, Ruling on Plaintiffs' Motion for Preliminary Injunction (D.Conn. Nov. 25, 1981). The brewers then moved for summary judgment in an effort to obtain an expedited resolution of this matter. The defendants responded with a cross-motion for summary judgment, supported by the affidavits of Charles W. Kasmer, a defendant and Secretary of the Department of Liquor Control, and Dr. Paul Weiner, an economist. In addition, the defendants submitted a statement of material facts pursuant to local rule 9(d) contesting some of the "material facts not in dispute" contained in plaintiffs' 9(d) statement. The parties waived oral argument on these motions in order to hasten the court's decision.

I. *Summary Judgment Principles*

> The requirements for granting summary judgment are well established. There must be "no genuine issue as to any material fact," and a party must be "entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c). "The burden is on the moving party 'to demonstrate the absence of any material factual issue genuinely in dispute.' *Heyman v. Commerce & Industry Insurance Co.*, 524 F.2d 1317, 1319-20 (2d Cir. 1975)." *American International Group, Inc. v. London American International Corp.*, [664 F.2d 348] (2d Cir. Nov. 13, 1981).

Schwabenbauer v. Board of Education, 667 F.2d 305, 313 (2d Cir. 1981). "A material fact is one which may affect the outcome of the litigation," *Commodity Futures Trading Commission v. Savage*, 611 F.2d 270, 282 (9th Cir. 1979) (citation omitted) or which "constitutes a legal defense to an action." *Kennett-Murray Corp. v. Bone*, 622 F.2d 887, 892 (5th Cir. 1980) (citation omitted).

> Not only must there be no genuine issue as to the evidentiary facts, but there must also be no controversy as to the inferences to be drawn from them. *E.g., Phoenix Savings & Loan, Inc. v. Aetna Casualty & Surety Co.*, 381 F.2d 245, 249 (4th Cir. 1967). In determining whether or not there is a genuine factual issue, the court should resolve all ambiguities and draw all reasonable inferences against the moving party. *United States v. Diebold, Inc.*, 369 U.S. 654, 655 [82 S.Ct. 993, 994, 8 L.Ed.2d 176] (1962) (per curiam); *Quinn v. Syracuse Model Neighborhood Corp.*, 613 F.2d 438, 445 (2d Cir. 1980).... [T]he fact that both sides have moved for summary judgment does

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[6] The statute took effect on January 1, 1982, but the contested provisions have just become applicable, since the first price posting under the Act was not until January 13, 1982, for prices effective on February 1, 1982. See letter of John F. Healy, Chairman, Liquor Control Commission, dated November 23, 1981.

not mean that the court must grant judgment as a matter of law for one side or the other. *E.g., Home Insurance Co. v. Aetna Casualty & Surety Co.*, 528 F.2d 1388, 1390 (2d Cir. 1976) ("The fact that both sides . . . sought summary judgment does not make it more readily available."); *Rhoads v. McFerran*, 517 F.2d 66, 67 (2d Cir. 1975).

Schwabenbauer, at 313–314.

[2] "[The Court does] not assume that no material facts remain in dispute simply because both parties moved for summary judgment." *Matter of Citizens Loan & Savings Co.*, 621 F.2d 911, 913 (8th Cir. 1980) (citation omitted). Rather, the court must evaluate each party's motion on its own merits to determine if summary disposition is appropriate.

[3] "[I]t is well settled [however] that even genuine disputed issues of fact will not preclude summary judgment unless they are material to the legal issues in the case." *Milwaukee Typographical Union No. 23 v. Newspapers, Inc.*, 639 F.2d 386, 392 n.5 (7th Cir.) (citation omitted), *cert. denied*, — U.S. —, 102 S.Ct. 144, 70 L.Ed.2d 119 (1981); *accord, British Airways Board v. Boeing Co.*, 585 F.2d 946, 952–53 (9th Cir. 1978), *cert. denied*, 440 U.S. 981, 99 S.Ct. 1790, 60 L.Ed.2d 241 (1979).

Applying these principles to the instant matter, the court concludes that this is an appropriate case for summary judgment. The defendants' objections to certain of the statements alleged to be "material facts not in dispute" in plaintiffs' 9(d) statement do not bar granting summary judgment, because these statements are either not material, or not facts at all. The objections to the brewers' statements relating to the nature of the beer industry are not material to the resolution of the legal issues presented by these motions.[7] The separate 9(d) statement submitted by Anheuser-Busch, Inc. concerns itself solely with the purpose behind the beer price affirmation statute. To the extent that Anheuser-Busch's statements are factual, the defendants' objections are not material.[8] To the extent the 9(d) statement states arguments or conclusions, the court is entitled to disregard them.

The statements of material facts submitted by the parties, along with the supporting affidavits, reveal the following pertinent facts:

1. Connecticut residents cross state borders in significant numbers to purchase beer at lower retail prices.[9]
2. The purpose of the beer price affirmation statute is to lower the price of

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[7] An example of this group of immaterial disputed facts is found in paragraph two of defendants' 9(d) statement. Whether or not beer is perishable, and what that term means, have absolutely no bearing on the legal issues in this case. Similarly, the other disputed facts about the price elasticity of beer, the market breakdowns, the nature of competition, etc., are not material.

[8] The court finds that paragraph one of Anheuser-Busch's 9(d) statement is a material fact not in dispute. Defendants' objection is a linguistic quibble, nothing more. Paragraph two is also material and not disputed, with the exception of the statement "regardless of competitive conditions." As this is not a factual statement, but an argument, the dispute is not material. Paragraph three states that "[a]s a result of these provisions, Connecticut wholesalers will receive a legislatively mandated competitive advantage over competing border state wholesalers and retailers." It continues, saying that whatever Anheuser-Busch does in response to the statute "will damage the competitive position of bordering state wholesalers and retailers *vis-a-vis* their Connecticut competitors and will result in injury to Anheuser-Busch . . . ." It is reasonably clear that neither of these statements are primarily factual, insofar as they state conclusions and predict future events. Because these parts of paragraph three are not statements of material facts not in dispute, the court will disregard them. The rest of paragraph three is arguably factual but is not material and need not be considered any further.

[9] Statement by Anheuser-Busch of Material Facts as to Which There is No Genuine Issue to be Tried (A–B's 9(d) statement) ¶ 1; Statement of Material Facts by Defendants John F. Healy, Et Al. (Defendants' 9(d) statement) ¶ 32.

beer to Connecticut consumers[10] thereby increasing the purchase of beer by Connecticut residents within the state, and generating increased tax revenues.[11]

3. There are no breweries in Connecticut.[12]
4. In each of the four relevant states the beer distribution system consists of three tiers as required by state licensing laws: brewers and importers, wholesalers, and retailers.[13]
5. The brewers and importers doing business in the four-state area have the following choices of how to comply with the beer price affirmation statute:[14]
   (a) the Connecticut price can be lowered to equal the lowest price in a bordering state;
   (b) lower prices in border states can be raised to the Connecticut level;
   (c) the brand or brands that sell at lower prices in the border states can be withdrawn from Connecticut;
   (d) the brand or brands that sell for lower prices in the border states can be withdrawn from the markets where the price is lower than the Connecticut price.

The court takes judicial notice of the following facts:

1. Connecticut's statutory scheme regulating the liquor industry contains the following provisions:

A. *Price Posting.* All brewers and importers of beer must file with the Department of Liquor Control a schedule of prices that they will charge to Connecticut wholesalers. Conn.Gen.Stat. § 30-63(c), Pub.Act 81-294 § 10(c). These "posted prices" apply to all sales to Connecticut wholesalers. They are subject to changes that can be filed on or before the thirteenth day of any month to become effective on the first day of the next month. The posted prices are per bottle, can, or case prices for every brand of beer in every size bottle or can without distinction based on the way the bottles or cans are packaged or even whether they are further packaged. Connecticut wholesalers must also post their prices. Posted prices cannot be changed between monthly posting dates.

B. *Discounts.* Neither brewers nor wholesalers may offer discounts or other inducements of any kind to their customers. Conn.Gen.Stat. § 30-63(b), Pub.Act 81-294 § 10(b). However, the Department of Liquor Control allows beer price alterations by brewers and importers known in the industry as a "post-off." A "post-off" is the functional equivalent of a temporary discount, designed to spark sales.[15] The posted price in Connecticut is the governing price on all sales of beer regardless of quantity or other circumstances of a particular sale.

C. *Price Differentiation Among Customers.* Neither brewers nor wholesalers may differentiate among their customers in respect of price or other terms of trade. Conn.Gen.Stat. § 30-63(b), Pub.Act 81-294 § 10(b).

D. *Sales Below Cost.* Sales below cost by brewers, importers, and wholesalers are prohibited. Conn.Gen.Stat. § 30-63(b), Pub.Act 81-294 § 17.

E. *Resale Prices.* Suggested consumer resale price schedules must be filed; compliance by retailers is not mandatory. Conn.Gen.Stat. § 30-64, Pub.Act 81-294 § 15.

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[10] Defendants' 9(d) statement ¶ 33.

[11] A-B's 9(d) statement ¶ 1; Defendants' 9(d) statement ¶¶ 12, 33.

[12] United States Brewers Association Statement of Material Facts Not in Dispute (USBA's 9(d) statement) ¶ 3.

[13] USBA's 9(d) statement ¶ 10.

[14] USBA's 9(d) statement ¶ 23.

[15] Affidavit of Charles W. Kasmer (Kasmer Aff.) ¶¶ 4-6.

F. *Minimum Markups.* Minimum markups for wholesale and retail beer prices which were required by law have been repealed by Public Act No 81-294 § 21, effective January 1, 1982.[16]

G. *Exclusive Territories.* Wholesalers are prohibited from selling to retailers located outside their designated territories.[17] However, a wholesaler's territory is determined by the brewer or importer under Conn.Gen.Stat. §§ 30-17 and 30-63, and may be as small or large as the brewer or importer chooses.[18]

H. *Bottle Bill.* The Connecticut bottle and can return bill requires that all beer (and soft drink) bottles and cans be redeemable for at least five cents, and also requires that brewers and importers put special labels on cans and bottles and special non-detachable tabs on cans. Conn.Gen.Stat. §§ 22a-78, 22a-88.[19]

2. The price affirmation statute requires the monthly posting of prices for beer by brewers and importers, and adherence to those prices during the month governed by the posting.[20] The relevant portions of the Connecticut statute may be summarized as follows:

A. Each brewer selling in Connecticut must affirm that its prices to Connecticut wholesalers are no higher than the lowest price it sells or offers to sell, during the month following, to any wholesaler in the three bordering states; sales in Connecticut at higher than this lowest price are prohibited.[21]

B. "Lowest price" is calculated net of all discounts, allowances and inducements of any kind offered to any bordering state wholesaler; due allowance can be made for differentials attributable to differences in state taxes and the actual cost of delivery.[22]

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[16] The beer price affirmation provisions are only one part of a larger statute which repealed the legally required minimum markups on alcoholic beverages. The title of the Act, "An Act Concerning the Elimination of Minimum Markups on Liquor Sales," indicates that repeal of minimum markups was the primary concern of the legislature. (See Remarks of Rep. Carragher, House (H)-68.) The stated purpose of the repeal was to benefit consumers by lowering prices of alcoholic beverages, thereby generating increased tax revenues for the state through increased sales. (See Remarks Rep. Carragher, H-70, 224-25; Rep. Moynihan, H-119; Sen. Schneller, Senate (S)-46.) Connecticut, due to its extensive regulations maintaining high prices and otherwise restricting free competition, has more retail stores per capita than any other state in the Union. (See Remarks Sen. Skelley, S-28; Sen. Johnson, S-35.) Many of these are so-called "Mom and Pop" stores, whose economic survival was thought to be dependent on the minimum markup laws. (See Remarks Sen. Johnson, S-36; Sen. Mustone, S-22, 24.) The legislature, in repealing minimum markups, was concerned with cushioning the impact of free competition on the small retail stores. (See Remarks Sen. Ballen, S-109-110; Rep. Carragher, H-224-227.) To this end, the legislation included several measures designed to protect small retailers from competition within the state. These so-called "safeguards" include: (1) a five-year moratorium on the issuance of new retail permits (Rep. Carragher, H-70, 219, 225; Sen. Mustone, S-18; Sen. Schneller, S-44-45); (2) after the expiration of the five-year moratorium, new retail permits may be issued only at the rate of one per 2,500 people in population growth (Sen. Mustone, S-19; Sen. Schneller, S-45; Rep. Carragher, H-219, 225); (3) abolition of one day permits for organizations, thereby requiring social groups to make quantity purchases from retailers (Sen. Mustone, S-19; Rep. Carragher, H-225); (4) retailers may purchase from wholesalers in another territory if the product is unavailable from their distributor or if the price is lower elsewhere (Sen. Mustone, S-19; Rep. Carragher, H-220-221, 226); (5) wholesalers cannot price differentiate among retailers (Rep. Carragher, H-225); (6) retailers cannot price below cost (Rep. Carragher, H-225); (7) no quantity discounts may be offered by brewers or wholesalers (Sen. Mustone, S-21; Rep. Carragher, H-226); (8) no person can own or have an interest in more than two retail liquor stores (Sen. Schneller, S-45; Rep. Carragher, H-220, 225-26); and (9) a three-day period in which wholesalers may revise their posted prices *downward* to compete with the lowest prices posted (Sen. Mustone, S-20; Rep. Carragher, H-220, 226).

[17] Department of Liquor Control Reg. § 30-6-37.

[18] Kasmer Aff. ¶ 8.

[19] USBA's 9(d) statement ¶ 20; Defendants' 9(d) statement ¶ 9.

[20] Conn.Gen.Stat. § 30-63(c), Pub.Act 81-294 § 10(c).

[21] Conn.Gen.Stat. §§ 30-63a(b), 63b(b), Pub.Act 81-294 §§ 11, 12.

C. No allowance is made for different package configurations (*e.g.* a case of six-packs versus a case of loose cans or bottles); in addition, for any brand a brewer offers for sale in Connecticut, it must offer to Connecticut wholesalers all the sizes of that brand offered to wholesalers in the three bordering states.[23]

II. *Beer Marketing in the Four-State Area*

Plaintiffs claim that the price affirmation statute impermissibly burdens interstate commerce insofar as it disrupts their business practices within the four-state area. To better understand the nature of plaintiffs' argument, it is necessary to provide some background on the present marketing practices of the brewers and importers, and the regulatory schemes of the bordering states.

All four states require licenses for those who market beer at each of the three levels involved; brewers, distributors and retailers. The net effect of this scheme is to entirely preclude sales by wholesalers in one state to retailers in another. At this point the uniformity ends. Massachusetts is similar to Connecticut in that it does have a price posting requirement applicable to brewers and importers,[24] although there is no requirement that the posted price be equal to the lowest price charged for the same item in some other place. Massachusetts, like Connecticut, also prohibits brewers or wholesalers from differentiating among their customers in respect of price or other terms of trade,[25] prohibits sales below cost by brewers, importers, and wholesalers,[26] and requires that consumer resale price schedules be filed, although compliance by retailers is not mandatory in either state.[27] And last, Massachusetts, like Connecticut, has recently passed a bottle bill which will require that cans and bottles be redeemable.[28]

In New York and Rhode Island brewers and importers, unfettered by extensive regulation, can and do offer a range of price discounts to wholesalers for a variety of reasons. Discounts are offered for quantity sales, sales to special customers (the so-called home distributors in New York), to encourage advertising by wholesalers, for purposes of test marketing new products, and for promotional purposes.[29]

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[22] Conn.Gen.Stat. § 30–63c(b), Pub.Act 81–294 § 13.

[23] Conn.Gen.Stat. § 30–63c(b), Pub.Act 81–294 § 13.

[24] *See* Mass.Ann.Laws ch. 138 § 25B, and Conn.Gen.Stat. § 30–63(c), Pub.Act 81–294 § 10(c). No change can be made in the posted price in Massachusetts or Connecticut except where there is a typographical error in the posting. The posted price, whether promotional or not, must continue for a full thirty days. Affidavit of Donnell E. Balmert (Balmert Aff.) C–5, ¶ 11.

[25] Mass.Ann.Laws ch. 138 § 25A, and Conn.Gen.Stat. § 30–63(b), Pub.Act 81–294 § 10(b).

[26] 204 Code Mass.Regs. § 2.04, and Conn.Gen.Stat. § 30–68i, Pub.Act 81–294 § 17.

[27] Mass.Ann.Laws ch. 138 § 25C, and Conn.Gen.Stat. § 30–64, Pub.Act 81–294 § 15.

[28] *See Boston Globe*, Tues. Nov. 17, 1981, pp. 1, 22. The Massachusetts statute takes effect on January 17, 1983. In addition to Massachusetts and Connecticut, five other states, Maine, Vermont, Oregon, Michigan and Iowa have bottle bills.

[29] Price promotions in New York must last at least six months. (Balmert Aff. C–6, ¶ 13.) The functional equivalent of price promotions can be achieved in Connecticut through the use of the "post-off." (Kasmer Aff. ¶¶ 4–6). Discounts may also be offered for particular package configurations, *e.g.* cases consisting of loose or individual bottles and cans. In Connecticut, posted prices must be per case, bottle or can and prices may not vary according to how the bottles or cans are packaged. Massachusetts does allow price promotions. (Affidavit of Michael J. LaMonica (LaMonica Aff.) A–10, ¶ 27.)

At present, the brewers' pricing policies in New York and Rhode Island are characterized by a good deal of flexibility and variability. The New York City market is the most highly competitive,[30] and accordingly, prices there are often the lowest in the four-state region.[31] Prices charged by brewers and importers to Connecticut wholesalers are neither the highest nor the lowest in the four-state area.[32] Retail prices in Connecticut, however, are generally higher than those in the bordering states.[33]

The beer price affirmation statute would force some changes in the current marketing practices employed by the brewers and importers. The statute requires that the brewers sell to Connecticut wholesalers at the lowest price the same item is being sold anywhere in the four-state region. If a particular brewer's lowest price in the region for a given item is being offered to a home-distributor[34] in New York City, the Connecticut statute would require that brewer to offer the item for the same price for the entire Connecticut market. The brewers and importers argue that competitive conditions do not justify selling at such low prices in Connecticut, and claim that by doing so they will suffer serious economic losses. Alternatively, the plaintiffs argue that if they raise their prices in the competitive New York City area they will be priced out of the market and will lose a significant portion of their business.[35]

In addition to its effect on prices, plaintiffs maintain that the statute will limit competition in the four-state area. Their argument here is that the statute will effectively preclude the brewers from lowering prices elsewhere once the price is posted in Connecticut. This loss of price flexibility will disrupt the current practice of offering short-term price discounts to wholesalers. In short, the plaintiffs argue, the Act will cause the "dislocation of marketing choices or the entire loss of markets in which investments have been made."[36]

III. *Plaintiffs' Contentions*

Plaintiffs' Commerce Clause argument is directed at both the purpose and effect of the Act. They argue, relying on comments from the legislative debates on the statute, that the legislative intent was to "protect Connecticut wholesalers and retailers from out-of-state competition."[37] Insofar as the purpose and effect of the price affirmation statute is to benefit local interests by discriminating against out-of-state concerns, it is "protectionist" legislation, constituting a *per se* violation of the Commerce Clause. *See Philadelphia v. New Jersey*, 437 U.S. 617, 624, 98 S.Ct. 2531, 2535, 57 L.Ed.2d 475 (1978).

The other prong of the Commerce Clause argument focuses only on the *effect* of the statute. Thus, even if the statute is evenhanded on its face, it may not stand if the burden it imposes on commerce is clearly excessive in relation to legitimate local interests. *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970). The brewers argue that the restrictions on price flexibility and the disruptive effects on their market practices are substantial burdens on interstate commerce, not justified by any legitimate state interest.[38] Additionally, plaintiffs argue that to the extent the statute reduces the flow of consumers across state lines to purchase beer it imposes an impermissible burden on interstate commerce.

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[30] LaMonica Aff. A–5, ¶ 14; Balmert Aff. C–7, ¶ 16; Affidavit of John D. Reifenrath D–4, ¶ 15.

[31] The upstate New York region is also highly competitive, due to the presence of Genesee, a popular regional beer. Narragansett provides similar intense local competition in Rhode Island. LaMonica Aff. A–7, ¶ 18; Affidavit of Dan Daly E–6, ¶ 12.

[32] USBA's 9(d) statement ¶ 22.

[33] USBA's 9(d) statement ¶ 21.

[34] Home distributors or vendors appear to be unique to New York. These home vendors apparently control large portions of the New York City market, dealing in large quantity sales to both wholesale and retail customers. They currently receive significant discounts from the brewers, which are passed along to quantity purchasers. *See* Affidavits of Dan Daly E–5, ¶ 10; Ralph Walder B–8, ¶ 13; and John Reifenrath D–5, ¶ 16.

[35] A third alternative is to withdraw from the Connecticut market. Obviously this might have economic consequences for the brewers which they hope to avoid.

[36] USBA's 9(d) statement ¶ 24.

[37] Anheuser-Busch's Memorandum in Support of its Motion for Summary Judgment (A–B's Brief on Sum. J.) at 3.

The plaintiffs' second major contention is that the statute violates the Supremacy Clause because it compels a violation of the Sherman Antitrust Act, 15 U.S.C. § 1. The brewers argue that the Connecticut law requires them to "fix minimum prices [they] will charge for beer in the states bordering Connecticut and to maintain those minimum prices until they are changed in accordance with Connecticut's monthly price posting requirements." In addition, they argue, the Act "necessitates a common refusal to deal with the competitors of some Connecticut beer wholesalers on terms more favorable than those offered to the Connecticut wholesalers even though more favorable terms would be justified by competitive conditions."[39] The brewers argue that the statute, in combination with the Massachusetts posting requirement, will require the announcement of future maximum prices for Connecticut, also in violation of the Sherman Act. Prices must be posted in Massachusetts on the first day of the month, effective the first day of the month following. These prices must not be lower than the prices posted in Connecticut on the thirteenth of the month, effective the following month. Thus the price posted in Massachusetts becomes, by the interaction of the two statutes, the maximum price which may be posted in Connecticut. These three effects, the brewers argue, constitute coerced violations of the Sherman Act, which are not protected by the doctrine of state immunity under *Parker v. Brown*, 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315 (1943).

Plaintiffs also advance two secondary arguments in support of their constitutional claims. First, that the price affirmation statute violates the Due Process Clause of the fourteenth amendment by (1) taking the brewers' property without just compensation, and (2) by regulating the beer business in the bordering states. A variation of this latter point is essentially the brewers' second argument: that the statute impermissibly infringes on the twenty-first amendment powers of the bordering states. The court will consider each of these four arguments in turn.

IV. *Discussion*

A. *The Commerce Clause*

[4-6] The starting point in an analysis of the constitutionality of the statute under the Commerce Clause is the twenty-first amendment, the second section of which provides that: "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." As the Supreme Court has consistently held, "That Amendment bestowed upon the states broad regulatory power over the liquor traffic within their territories." *United States v. Frankfort Distilleries, Inc.*, 324 U.S. 293, 299, 65 S.Ct. 661, 664, 89 L.Ed. 951 (1945) (footnote omitted). State statutes regulating alcoholic beverages are entitled to a presumption of validity in light of the broad scope of power in this area. *Cali-*

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[38] The brewers argue that even if reducing beer prices is a legitimate state goal, the statute is not designed to achieve it, since it does not ensure that the reduction in price to Connecticut wholesalers will be passed along to retailers and consumers.

See USBA's Brief in Support of Motion for Preliminary Injunction at 48. If, however, the price reduction is not passed along, then Connecticut consumers will continue to purchase beer out of state, and the benefit to Connecticut retailers and wholesalers will not materialize. Only if the prices fall low enough to induce Connecticut consumers to buy within the state can the statute even arguably disadvantage out-of-state businesses. It thus does plaintiffs little good to argue that the statute is ill-designed to achieve the goal which they argue makes it unconstitutional. *See* note 53 *infra*.

[39] USBA's Memorandum in Support of its Motion for Preliminary Injunction (USBA's Brief on Pre. Inj.) at 25.

fornia v. LaRue, 409 U.S. 109, 118–19, 93 S.Ct. 390, 397–398, 34 L.Ed.2d 342 (1972). "[T]he second section of the Twenty-first Amendment [however] has not operated totally to repeal the Commerce Clause in the area of the regulation of traffic in liquor." *Seagram & Sons v. Hostetter*, 384 U.S. 35, 42, 86 S.Ct. 1254, 1259, 16 L.Ed.2d 336 (1966).

The general principles of the Commerce Clause were restated recently in *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 100 S.Ct. 2009, 64 L.Ed.2d 702 (1980):

> The Commerce Clause grants to Congress the power "[t]o regulate Commerce ... among the several States." U.S.Const., Art. 1, § 8, cl. 3. Although the Clause thus speaks in terms of powers bestowed upon Congress, the Court long has recognized that it also limits the power of the States to erect barriers against interstate trade. See, *e.g.*, *Hughes v. Oklahoma*, 441 U.S. 322, 326 [99 S.Ct. 1727, 1731, 60 L.Ed.2d 250] (1979); *Philadelphia v. New Jersey*, 437 U.S. 617, 623 [98 S.Ct. 2531, 2535, 57 L.Ed.2d 475] (1978); *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 534–538 [69 S.Ct. 657, 663–665, 93 L.Ed. 865] (1949); *Cooley v. Board of Wardens*, 12 How. 299 [13 L.Ed. 996] (1852). This limitation upon state power, of course, is by no means absolute. In the absence of conflicting federal legislation, the States retain authority under their general police powers to regulate matters of "legitimate local concern," even though interstate commerce may be affected. See, *e.g.*, *Raymond Motor Transportation, Inc. v. Rice*, 434 U.S. 429, 440 [98 S.Ct. 787, 793, 54 L.Ed.2d 664] (1978); *Great A & P Tea Co. v. Cottrell*, 424 U.S. 366, 371 [96 S.Ct. 923, 927, 47 L.Ed.2d 55] (1976). Where such legitimate local interests are implicated, defining the appropriate scope for state regulation is often a matter of "delicate adjustment." *Ibid.*, quoting *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S., at 553 [69 S.Ct., at 679] (Black, J., dissenting). Yet even in regulating to protect local interests, the States generally must act in a manner consistent with the "ultimate ... principle that one state in its dealings with another may not place itself in a position of economic isolation." *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 [55 S.Ct. 497, 502, 79 L.Ed. 1032] (1935). However important the state interest at hand, "it may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently." *Philadelphia v. New Jersey*, 437 U.S., at 626–627 [98 S.Ct., at 2537].
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> Over the years, the Court has used a variety of formulations for the Commerce Clause limitation upon the States, but it consistently has distinguished between outright protectionism and more indirect burdens on the free flow of trade. The Court has observed that "where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected." *Id.*, at 624 [98 S.Ct., at 2535]. In contrast, legislation that visits its effects equally upon both interstate and local business may survive constitutional scrutiny if it is narrowly drawn. The Court stated in *Pike v. Bruch Church, Inc.*, 397 U.S. 137 [90 S.Ct. 844, 25 L.Ed.2d 174] (1970):
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> > "Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.... If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." *Id.*, at 142 [90 S.Ct., at 847].
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> See also *Hughes v. Oklahoma*, 441 U.S., at 336 [99 S.Ct., at 1736]; *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 353 [97 S.Ct. 2434, 2446, 53 L.Ed.2d 383] (1977); *Great A & P Tea Co. v. Cottrell*, 424 U.S., at 371–372 [96 S.Ct.,

> at 927–928]; *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 443 [80 S.Ct. 813, 815, 4 L.Ed.2d 852] (1960). The principal focus of inquiry must be the practical operation of the statute, since the validity of state laws must be judged chiefly in terms of their probable effects. See *Hughes v. Oklahoma*, 441 U.S., at 336 [99 S.Ct., at 1736]; *Best & Co. v. Maxwell*, 311 U.S. 454, 455–456 [61 S.Ct. 334, 335, 85 L.Ed. 275] (1940).

Id. at 35–37, 100 S.Ct. at 2015–2016.

1. *"Protectionist" Legislation*

a. Discriminatory Purpose

Plaintiffs argue that the purpose of the price affirmation statute was to protect local businesses from competition with their out-of-state counterparts.[40] There is nothing in the record, however, to support this contention.[41] As mentioned above, there are no brewers or importers in Connecticut, so the statute could not possibly benefit local brewers. The statute mandates only that Connecticut wholesalers be treated as well as out-of-state wholesalers with respect to price. The legislative intent to secure "fairer" or "more equal" competition can hardly be characterized as "protectionist" within the meaning of the Commerce Clause. Because neither the statute nor the legislative debates reveal an avowed purpose to discriminate against out-of-state businesses, the statute cannot be invalidated on the basis of its purpose alone.[42]

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[40] A–B's Brief on Sum. J. at 3.

[41] The brewers point to several statements in the legislative debates to support their contention that the statute has a discriminatory purpose. The isolated comments of a few individuals, however, cannot fairly be ascribed to the legislature as a whole. The statements were not those of the sponsors of the bill, nor were they in any way endorsed by the other members. See note 16, *supra*, for a more complete discussion of the legislative debates.

[42] While the Supreme Court has indicated that "economic protectionism" may be shown by "proof of either discriminatory effect, see *Philadelphia v. New Jersey*, 437 U.S. 617 [98 S.Ct. 2531, 57 L.Ed.2d 475] (1978) or of discriminatory purpose, see *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 352–353 [97 S.Ct. 2434, 2446–2447, 53 L.Ed.2d 383] (1977)," *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 101 S.Ct. 715, 727 n.15, 66 L.Ed.2d 659, it is hard to find a case where purpose alone has invalidated a statute. The citation to *Hunt v. Washington Apple* in support of the proposition that discriminatory purpose *alone* is sufficient for a finding that a state law is "protectionist" appears to be incorrect. In *Hunt*, the Court stated that

> we need not ascribe an economic protection motive to the North Carolina legislature to resolve this case; we conclude that the challenged statute cannot stand insofar as it prohibits the display of Washington State grades even if enacted for the declared purpose of protecting consumers from deception and fraud in the market place.

Id. 432 U.S. at 352–53, 97 S.Ct. at 2446. It is reasonably clear from this quotation that *Hunt* did not involve a finding of discriminatory *purpose*, but rather rested on the existence of a discriminatory *effect*. *See Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. at 351–52, 97 S.Ct., at 2445–2446. As the Court has recognized, it is a "rare instance where a state artlessly discloses an avowed purpose to discriminate against interstate goods." *Dean Milk Co. v. Madison*, 340 U.S. 349, 354, 71 S.Ct. 295, 298, 95 L.Ed. 329 (1951). Because states almost always can, and do, advance legitimate reasons to justify a particular statute, the Court, when considering the *purpose* of a challenged statute, will not be bound by " '[t]he name, description or characterization given it by the legislature or the Courts of the State,' but will determine for itself the practical *impact* of the law." *Hughes v. Oklahoma*, 441 U.S. 322, 336, 99 S.Ct. 1727, 1736, 60 L.Ed.2d 250 (1979) (emphasis added), quoting *Lacoste v. Louisiana Dept. of Conservation*, 263 U.S. 545, 550 44 S.Ct. 186, 188, 68 L.Ed. 437 (1924). Invariably the Court infers discriminatory *purpose* only when there is a prior finding of discriminatory *impact*. The inquiry in each case requires first, a determination of whether a discriminatory effect exists, and second, an evaluation of the declared state purpose in light of the means chosen to attain it. Only where the discriminatory effect appears to stem primarily from a design to protect local interests and only secondarily from the pursuit of a legitimate state goal, has the Court inferred a "protectionist" purpose. The Court has rarely, if ever, invalidated a statute on the basis of a discriminatory purpose where there was not proof of actual or inevitable discriminatory effects. While the Court would be entitled to invalidate a statute with the avowed purpose of discriminating against interstate commerce on the assumption that it will have the desired effect, the opportunity rarely presents itself. As noted above, states are rarely so bold as to announce their intention to violate the Constitution, and the instant case is no exception to the rule.

b. Discriminatory Effect

Plaintiffs argue that regardless of its purpose the statute has a discriminatory *effect* on out-of-state *wholesalers* and *retailers*. It is significant that the brewers here are attempting to invalidate the statute not because of its direct effects on them, but because of its indirect effects on third parties. They do not argue that the statute discriminates against out-of-state brewers or importers for the simple reason that there are no Connecticut brewers or importers. *See Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 125, 98 S.Ct. 2207, 2213, 57 L.Ed.2d 91 (1978).

The brewers assert that the statute discriminates against out-of-state wholesalers and retailers. It is difficult, however, to conceive of the nature of the alleged discrimination. The statute does not affect any business out-of-state wholesalers or retailers conduct *in* Connecticut, since they are not permitted by law to sell beer within the state. Nor does the statute affect any rights to which out-of-state wholesalers or retailers are entitled. The brewers' argument, based on *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 351–52, 97 S.Ct. 2434, 2445–2446, 53 L.Ed.2d 383 (1977), that the statute strips out-of-state retailers of a competitive advantage—lower prices—misses the point. Out-of-state wholesalers and retailers are not entitled to receive prices lower than those charged to their Connecticut counterparts. The out-of-state wholesalers and retailers have not, and could not complain that the statute takes from them the advantage of lower prices, when they have no right to those prices in the first place. If Connecticut may constitutionally regulate the prices brewers charge to their wholesalers, then it would seem to follow that the brewers may not complain about the incidental effects on their out-of-state customers when those effects do not implicate constitutional rights. Since it is clear that out-of-state wholesalers and retailers have no right, constitutional or otherwise, to receive lower beer prices from the brewers, there is nothing about which the brewers may complain. I therefore hold that the beer price affirmation statute does not discriminate against out-of-state businesses and does not, in this respect, contravene the Commerce Clause.[43]

2. *Burden on Interstate Commerce*

Concluding that the statute does not have a discriminatory purpose or effect does not end the inquiry under the Commerce Clause. It still remains to be determined (1) whether the statute burdens interstate commerce, (2) whether such burden is incidental to a regulation effectuating a legitimate local public interest, and (3) whether the burden imposed is excessive in relation to putative local benefits. "If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970).

a. Beer

In the instant case, the first question is whether the beer price affirmation statute burdens interstate commerce in beer.[44] I have already noted that the statute does not discriminate against brewers, but it may nevertheless impermissibly burden the movement of beer in interstate commerce.

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[43] In the instant case, the most that can be said of the statute is that it will shift some business from out-of-state retailers to in-state retailers. Recently, however, the Supreme Court indicated that "[a] nondiscriminatory regulation serving substantial state purposes is not invalid simply because it causes some business to shift from a predominantly out-of-state industry to a predominantly in-state industry." *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 101 S.Ct. 715, 729, 66 L.Ed.2d 659 (1981). In light of this quotation it is clear that the shifting of business, standing alone, does not render the statute invalid.

[44] It should be pointed out that Connecticut has had nationwide price affirmation for liquor since 1973. *See* Conn.Gen.Stat. §§ 30–63(a), (b), (c), Pub.Act 73–387.

The plaintiffs argue quite forcefully that the statute's effect on their marketing practices will be so disruptive as to constitute a burden on interstate commerce. They point to several specific aspects of their marketing practices which will have to be altered in order to comply with the Connecticut statute.[45] In addition, plaintiffs argue that the price affirmation statute will have "dislocating effects on competition in the bordering states," constituting a substantial burden on commerce.[46] In short, plaintiffs contend the Connecticut legislation places an impermissible burden on interstate commerce.

The constitutionality of a price affirmation statute was upheld by the Supreme Court in *Seagram & Sons v. Hostetter*, 384 U.S. 35, 86 S.Ct. 1256, 16 L.Ed.2d 336 (1966), where it considered an attack on a New York statute which required distillers or distributors to sell liquor to New York wholesalers at the lowest price charged for the same item anywhere else in the *nation*.[47] The Court held that

> [t]he mere fact that § 9 [the price affirmation provision] is geared to appellant's pricing policies in other States is not sufficient to invalidate the statute. As part of its regulatory scheme for the sale of liquor, New York may constitutionally insist that liquor prices to domestic wholesalers and retailers be as low as prices offered elsewhere in the country. The serious discriminatory effects of § 9 alleged by appellants on their business outside New York are largely matters of conjecture. . . . It will be time enough to assess the alleged extraterritorial effects of § 9 when a case arises that clearly presents them. "The mere fact that state action may have repercussions beyond state lines is of no judicial significance so long as the action is not within that domain which the Constitution forbids." *Osborn v. Ozlin*, 310 U.S. 53, 62 [60 S.Ct. 758, 761, 84 L.Ed. 1074] [(1940)].

Id. at 43, 86 S.Ct. at 1260 (other citations omitted). The Court's holding, however, was limited by the following language:

> Although it is possible that specific future applications of [the statute] may engender concrete problems of constitutional dimension, it will be time enough to consider any such problems when they arise. We deal here only with the statute on its face. And we hold that, so considered, the legislation is constitutionally valid.

Id. at 52, 86 S.Ct. at 1265.

Plaintiffs in the instant case argue that it is distinguishable from *Seagram v. Hostetter* on its facts. That is, they claim that the affidavits in this case present the "concrete problems" which were lacking in *Seagram*, and therefore that the time has arisen to consider them. Plaintiffs assert that the Connecticut statute, even if constitutional on its face, is unconstitutional as applied to them in these circumstances. In addition, the brewers argue that the recent decision in *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*, 445 U.S. 97, 100 S.Ct. 937, 63 L.Ed.2d 233 (1980), implies that the Court has abandoned or modified its analysis in *Seagram* in favor of stricter scrutiny of state laws regulating alcohol, where they conflict with the federal commerce power.

Plaintiffs' attempts to distinguish *Seagram* on a factual or doctrinal basis are not persuasive.[48] Recognizing that *Seagram* does leave open the possibility of a different result where a stronger factual record of discriminatory effect exists, I do not believe the brewers have presented such a case.[49] As indicated above, the price affirmation statute does not discriminate against any of these brewers. Nor does the fact that the Connecticut statute regulates beer and not liquor suffice to distinguish this case from *Seagram*, regardless of the differences in the products or the way they are marketed. The plaintiffs' attempt to distinguish the instant case on the basis of a forbidden purpose is, in light of the discussion in the preceding section, similarly unavailing. In short, nothing about the "facts"[50] in this case is sufficient to distinguish it from *Seagram v. Hostetter*.

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[45] These include limiting the use of quantity discounts, promotional discounts, advertising discounts, test marketing and restricting the plaintiffs' price flexibility.

[46] USBA's Brief on Pre.Inj. at 37–38.

[47] The New York affirmation statute was also part of a legislative package which repealed minimum markups. It reflected the perception of the New York legislature that prices charged to New York wholesalers were higher than retail prices elsewhere. *See* 384 U.S. at 39 n.9, 86 S.Ct. at 1258 n.9. For a description of the New York statute see 384 U.S. at 39–41, 86 S.Ct. at 1257–1259.

[48] The plaintiffs' attempt to relegate *Seagram* to a "different era" of Commerce Clause adjudication is not persuasive. Nothing in *California Liquor Dealers v. Midcal*, 445 U.S. 97, 100 S.Ct. 937, 63 L.Ed.2d 233 (1980) implies that *Seagram* is no longer good law, or that the states' power under the twenty-first amend-

This conclusion is buttressed by the Court's opinion in *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 98 S.Ct. 2207, 57 L.Ed.2d 91 (1978). That case involved a Maryland statute which (1) prohibited producers or refiners of gasoline from operating retail service stations within the state and (2) required them to extend "voluntary allowances" (temporary price reductions) to all service stations. *See id.* at 119–20, 98 S.Ct. at 2211. The oil companies, as the brewers here, argued that the statute violated the Commerce Clause by discriminating against and unduly burdening interstate commerce. *Id.* at 125, 98 S.Ct. at 2213. The Court rejected the discrimination claim because there were no local producers or refiners which benefited from the statute. *Id.* In response to the claim that the statute impermissibly burdened interstate commerce, the Court stated as follows:

> The crux of appellants' [Exxon's] claim is that, regardless of whether the State has interfered with the movement of goods in interstate commerce, it has interfered "with the natural functioning of the interstate market either through prohibition or through burdensome regulation." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 [96 S.Ct. 2488, 2496, 49 L.Ed.2d 220] [(1976)]. . . . *We cannot, however, accept appellants' underlying notion that the Commerce Clause protects the particular structure or methods of operation in a retail market.* See *Breard v. Alexandria*, 341 U.S. 622 [71 S.Ct. 920, 95 L.Ed. 1233] [(1951)]. As indicated by the Court in *Hughes*, the Clause protects the interstate market, not particular interstate firms, from prohibitive or burdensome regulations.

Exxon v. Maryland, 437 U.S. at 127–28, 98 S.Ct. at 2214–2215 (emphasis added).

[7] The court views plaintiffs' claims in the instant case as essentially the same as

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ment is more restricted than it was fifteen years ago. The fact that the Court in *Midcal* began with an analysis of the Sherman Act issue, instead of the twenty-first amendment, is hardly a "telling indication of the shift in the Court's perspective on the accommodation of the Commerce Clause and the Twenty-first Amendment between 1966 when *Seagram* was decided and *Midcal* in 1980." USBA's Brief on Pre. Inj. at 25 n.1. There are any number of good reasons why the Court structured its opinions differently, the most obvious being the fact that they reached opposite conclusions. Whatever the reason for the organization of the opinion in *Midcal*, this court looks to the content of that opinion for guidance. And nothing the Court said in *Midcal* indicates that *Seagram* is no longer good law. *See* 445 U.S. at 106–10, 100 S.Ct. at 943–946.

[49] The brewers argue that this case presents a factual record which was missing in *Seagram v. Hostetter*. This record consists of the affidavits of brewers and importers outlining their market practices and indicating the options they have and the effects of complying with the affirmation law. In addition, plaintiffs have submitted the affidavit of Dr. Owen, an antitrust expert, stating the likely effects of the statute on competition in the beer industry. The court takes note, however, that the distillers in *Seagram* also submitted affidavits setting forth the difficulties in complying with the law and indicating the terrible consequences it would have on their marketing practices. *See generally* pp. 199–248 in the Supreme Court record. The only difference between this case and *Seagram*, then, is the affidavit of Dr. Owen. Without intimating any view as to the adequacy of Dr. Owen's analysis, the court does not believe his affidavit alone is sufficient to distinguish this case from *Seagram* on its *facts*.

[50] Of course, the brewers' contentions are not facts in the sense that they describe historical events. The brewers' affidavits only predict what will occur when the statute takes effect.

those raised by the oil companies in *Exxon.* Plaintiffs argue that the statute will result in the "dislocating of the existing beer distribution system," and equate such dislocation with a "substantial adverse impact on commerce."[51] While the beer price affirmation statute may interfere with the "natural functioning of the interstate market" and force changes in the "particular structure or methods of operation" in the beer market, *Exxon v. Maryland* makes it clear that this alone does not constitute an impermissible burden on interstate commerce. *See id.* at 127, 98 S.Ct. at 2214. Even assuming that some of the brewers or importers withdraw from the Connecticut market, as they threaten to do, it does not follow that the statute impermissibly burdens interstate commerce. As the Court indicated in *Exxon v. Maryland,* withdrawal from a particular market is not necessarily a burden on commerce.

> Some refiners may choose to withdraw entirely from the Maryland market, but there is no reason to assume that their share of the entire supply will not be promptly replaced by other interstate refiners. The source of the consumers' supply may switch from company-operated stations to independent dealers, but interstate commerce is not subjected to an impermissible burden simply because an otherwise valid regulation causes some business to shift from one interstate supplier to another.

Id. at 127, 98 S.Ct. at 2214.

Similarly, in the instant case there is no reason to believe that the withdrawal of some brewers or importers from Connecticut will not be compensated by increased sales by other brewers or importers. Since all beer sold in the state travels in interstate commerce, withdrawal will simply shift business from one interstate supplier to another. This is clearly permissible under the holding in *Exxon v. Maryland.* The basic beer pricing decisions which underlie the brewers' competitive strategies is left to them, and each may strike the balance it chooses. I therefore hold that the beer price affirmation statute does not place an impermissible burden on the movement of beer in interstate commerce.[52]

b. Consumers

[8] The brewers' second argument is that the price affirmation statute burdens interstate commerce by restricting the movement of consumers across state lines. Once again the brewers are invoking the rights of third parties. Here, however, the brewers and the consumers on whose behalf they argue have antagonistic interests. It thus becomes necessary to consider whether the brewers may assert claims relating to the constitutional rights of third parties.

[9] Plaintiffs do not have standing to raise the consumers' claim that the statute burdens their freedom of movement in interstate commerce. As the Court observed in *Warth v. Seldin,* 422 U.S. 490, 95 S.Ct. 2197, 45 L.Ed.2d 343 (1975), a "plaintiff generally must assert his own legal rights and interests, and cannot rest his claim to relief on the legal rights or interest of third parties." *Id.* at 499, 95 S.Ct. at 2205. *See also Valley Forge Christian College v. Americans United for Separation of Church and State,* — U.S. —, 102 S.Ct. 752, 70 L.Ed.2d — (1982); *Arlington Heights v. Metropolitan Housing Development Corp.,* 429 U.S. 252, 263, 97 S.Ct. 555, 562, 50 L.Ed.2d 450 (1977); *Tileston v. Ullman,* 318 U.S. 44, 46, 63 S.Ct. 493, 494, 87 L.Ed. 603 (1943) (per curiam). While the Court has allowed plaintiffs to assert the constitutional rights of third parties under "peculiar circumstances," this is not such a case. *See Barrows v. Jackson,* 346 U.S. 249, 256–57, 73 S.Ct. 1031, 1035, 97 L.Ed. 1586 (1953). Because plaintiffs' interests are antagonistic to those of the group whose rights they seek to assert, this case is particularly inappropriate for finding an exception to the prudential limitation on standing embodied in *Warth v. Seldin.*

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[51] USBA's Brief on Pre. Inj. at 39.

[52] Because the statute does not burden interstate commerce in beer, it is unnecessary to employ the "balancing test" of *Pike v. Bruce Church, Inc.,* 397 U.S. at 142, 90 S.Ct. at 847.

[10, 11] Even assuming, however, that plaintiffs do have standing to assert the rights of consumers, the brewers' argument must be rejected. While it is true that the Commerce Clause protects persons from restraints on their movements across state lines, *Service Machine & Shipbuilding Corp. v. Edwards*, 617 F.2d 70, 73 (5th Cir.), *aff'd*, 449 U.S. 913, 101 S.Ct. 310, 66 L.Ed.2d 142 (1980), citing *Edwards v. California*, 314 U.S. 160, 172, 62 S.Ct. 164, 166, 86 L.Ed. 119 (1941), not everything which affects the movement of persons is a burden on interstate commerce. A burden is only that which imposes a restrictive or onerous load upon interstate commerce. The restriction must prevent or limit the exercise of the right to freedom of movement to rise to the level of a Commerce Clause violation. A statute which creates disincentives to travel across state lines by imposing costs on those who wish to do so, would also be characterized as a burden on interstate commerce. *See Service Mach. & Ship. v. Edwards*, 617 F.2d at 76.

The statute in the instant case does not prohibit or otherwise limit the movement of consumers across state lines. Any consumers who wish to continue driving to bordering states to purchase beer may do so. The statute may reduce the incentives for Connecticut consumers to drive out of state for purchases of beer, but it does not involuntarily restrict their movements. That consumers may, of their own free will, decide not to drive to bordering states to purchase beer can hardly be characterized as a burden on interstate commerce.

[12] It is noteworthy that Connecticut consumers have not complained that the statute restricts their freedom of movement in interstate commerce. Nor are they likely to do so, since consumers are the ones who will benefit from lower beer prices in Connecticut. Far from imposing a burden on their movements, the statute relieves consumers of the burden of traveling to bordering states merely to purchase beer. While it may be that the price affirmation statute will reduce the flow of Connecticut consumers across state lines, it does not do so by imposing a burden on interstate commerce. The statute does not act by compulsion in limiting the flow of consumers in interstate commerce. At most it may encourage consumers to *voluntarily* restrict their out-of-state purchases of beer. Such a restriction, self-imposed by consumers acting out of enlightened self-interest, is simply not a burden on interstate commerce.[53]

B. *The Sherman Act*

[13] Plaintiffs' second contention, that the price affirmation statute violates the Supremacy Clause by mandating conduct violative of the Sherman Act, does not require extended discussion. This same argument was raised in *Seagram & Sons v. Hostetter*, 384 U.S. 35, 86 S.Ct. 1254, 16 L.Ed.2d 336 and rejected by the Court. "Section 9 [the price affirmation provision] imposes no irresistible economic pressure on the appellants to violate the Sherman Act in order to comply with the requirements of § 9." *Id.* at 45, 86 S.Ct. at 1261.

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[53] Even assuming *arguendo* that the statute does burden the movements of consumers in interstate commerce, it still would withstand the balancing test of *Pike v. Bruce Church, Inc.* The state's interest in reducing the price of beer is certainly a legitimate local interest. *Pharmaceutical Society of State of New York v. Lefkowitz*, 586 F.2d 953, 957 (2d Cir. 1978) (potential saving to New York consumers from lower priced generic drugs represents legitimate interest). Nor does it appear that Connecticut can achieve this result without having the same impact on the interstate movement of consumers. Anything which reduces the price differential between retail prices in Connecticut and those in the bordering states will reduce the incentives for out-of-state purchases of beer and thus tend to limit the flow of traffic across state lines. Thus, even if Connecticut adopted the plaintiffs' suggestion and repealed its restrictive regulations, this would not impose a lesser burden on interstate activity if beer prices declined as significantly as they may under affirmation. Since incidental burdens on interstate commerce will only invalidate state legislation where the burdens are "clearly excessive," *Pike v. Bruce Church, Inc.*, 397 U.S. at 142, 90 S.Ct. at 847, any burdens which the statute imposes fall short of this standard. Thus even accepting the brewers' argument on its terms, the statute does not violate the Commerce Clause.

The brewers argue, however, that the New York statute in *Seagram* was significantly different from the Connecticut statute here, inasmuch as the former required only that posted prices for a given item be no higher than the lowest price at which such item was sold in the nation during the *previous* month. The Connecticut statute, on the other hand, requires that posted prices be the lowest at which the item will be sold in the *coming* month. Because it is geared to the future, the Connecticut statute effectively sets minimum prices for the four-state area once the price is posted in Connecticut on the thirteenth of the month. The New York law in *Seagram*, with its referent in the past, had no such effect. This difference, plaintiffs argue, is grounds for distinguishing *Seagram* and finding a Sherman Act violation.

[14] The basic flaw in plaintiffs' argument was pointed out by the court in its ruling on the motion for preliminary injunction. "Absent an agreement among private parties, there cannot be a violation of section one of the Sherman Act, 15 U.S.C. § 1." *United States Brewers Ass'n v. Healy*, slip op. at 13. The plaintiffs argue that the court is in error, relying on *California Retail Liquor Dealers Association v. Midcal Aluminum, Inc.*, 445 U.S. 97, 100 S.Ct. 937, 63 L.Ed.2d 233 (1980) for the proposition that no agreement is necessary to constitute a violation of section one. In *Midcal*, the Supreme Court struck down a California statute which required wine producers to fix minimum prices at which wholesalers could resell the wine. *Id.* at 103, 100 S.Ct. at 942. The Court noted that the system "not only permitted vertical control of prices by producers, but also frequently resulted in horizontal price fixing." *Id.* at 101 & n.3, 100 S.Ct. at 941 & n.3. Relying on a long line of cases holding that resale price maintenance illegally restrains trade, *see Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 407, 31 S.Ct. 376, 384, 55 L.Ed. 502 (1911) and finding no immunity under the state action doctrine of *Parker v. Brown*, 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315 (1943), the Court invalidated the California statute.

Plaintiffs err in their assertion that *Midcal* eliminated the requirement of an agreement for a violation of section one. The Court there indicated that resale price maintenance is the equivalent of an agreement between wholesalers not to compete, *id.*, 445 U.S. at 103, 100 S.Ct. at 942, since the resale restrictions set the prices wholesalers charge retailers. Invariably, the Supreme Court has viewed resale price maintenance as involving an implicit agreement in those instances where an explicit agreement was not shown. In *United States v. Parke, Davis & Co.*, 362 U.S. 29, 80 S.Ct. 503, 4 L.Ed.2d 505 (1960) the Court "held that an illegal combination to fix prices results if a seller suggests resale prices and secures compliance by means in addition to the 'mere announcement of his policy and the simple refusal to deal ....' *Id.* at 44 [80 S.Ct. at 512]." *Albrecht v. Herald Co.*, 390 U.S. 145, 149, 88 S.Ct. 869, 871, 19 L.Ed.2d 998 (1968). The other cases cited by the Supreme Court in *Midcal* all involved actual contracts between manufacturers and wholesalers and/or retailers setting the resale prices. *See Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 385, 71 S.Ct. 745, 746, 95 L.Ed. 1035 (1951) (distillers made retailers sign price fixing contracts); *Kiefer-Stewart Co. v. Seagram & Sons, Inc.*, 340 U.S. 211, 213, 71 S.Ct. 259, 260, 95 L.Ed. 219 (1951) (Seagram refused to sell unless purchaser agreed to maximum resale price); *United States v. A. Schrader's Son, Inc.*, 252 U.S. 85, 95, 40 S.Ct. 251, 252, 64 L.Ed. 471 (1920) (defendant executed uniform contracts with tire manufacturers); *Dr. Miles Medical Co. v. John D. Park & Sons Co.*, 220 U.S. 373, 394, 31 S.Ct. 376, 379, 55 L.Ed. 502 (1911) (manufacturer adopted two forms of restrictive agreements).

That *Midcal* did not remove the requirement of an agreement can be seen in a close reading of the case itself. The statute there required "wine producers to enter into trade *contracts* with wholesalers, or establish binding resale price *schedules* for wholesalers." *Serlin Wine & Spirit Mer-*

chants, Inc. v. Healy; 512 F.Supp. 936, 938 (D.Conn.1981) (emphasis added). The Second Circuit Court of Appeals, in affirming *Serlin v. Healy*, indicated that *Midcal* did involve an agreement. In distinguishing the Connecticut statute there under attack, the court stated: "[u]nlike the California statute in *Midcal*, the Connecticut statutes do not authorize or compel private parties to enter *contracts* or *combinations* to fix prices in violation of § 1 of the Sherman Act." *Morgan v. Division of Liquor Control*, 664 F.2d 353, 355 (2d Cir. Nov.16, 1981) (emphasis added). Because *Midcal* involved either an express or implied agreement, plaintiffs' argument must be rejected.

It is clear then, that

> [s]ection 1 of the Sherman Act, which proscribes every "contract, combination, or conspiracy" in restraint of trade, is directed only at joint action. *Ford Motor Co. v. Webster's Auto Sales, Inc.*, 361 F.2d 874, 878 (1st Cir. 1966). It does not prohibit independent business actions and decisions.... Fundamental then to any § 1 claim is the finding of an agreement, express or otherwise, between two or more persons.

Modern Home Institute, Inc. v. Hartford Accident & Indemnity Co., 513 F.2d 102, 108–09 (2d Cir. 1975). *See also Fuchs Sugars & Syrups, Inc. v. Amstar Corp.*, 602 F.2d 1025, 1029 (2d Cir.), *cert. denied*, 444 U.S. 917, 100 S.Ct. 232, 62 L.Ed.2d 172 (1979). It is also clear that the beer price affirmation statute requires only unilateral action by each brewer and importer. It does not require conduct which the antitrust laws forbid, and does not exert "irresistible economic pressure" on the plaintiffs to violate the Sherman Act. It follows that the statute does not implicate the Supremacy Clause, and, therefore, plaintiffs' argument must be rejected.[84]

C. *Due Process*

[15] Plaintiffs claim that the price affirmation statute violates the Due Process Clause in two respects. First, that it constitutes a "taking" of property without just compensation, and second, that it regulates the beer business in the bordering states, thus exceeding the jurisdictional limitations on state authority.[85] These arguments need not detain us long.

As the court stated in its previous ruling in this case,

> the statute cannot reasonably be characterized as a "taking" of property without due process, because it does not force any brewers to do business in Connecticut at a loss. The mere fact that the plaintiffs' business in Connecticut may decline in value due to the price affirmation statute does not constitute a "taking" of property without just compensation. *See Penn Central Transportation Co. v. New York City*, 438 U.S. 104 [131, 98 S.Ct. 2646, 2662, 57 L.Ed.2d 631] (1978). And even if some brewers choose to cease doing business in Connecticut, that too would not constitute a taking of property. [*See Exxon v. Maryland*, 437 U.S. 117, 127, 98 S.Ct. 2207, 2214, 57 L.Ed.2d 91 (1978)].

United States Brewers Ass'n v. Healy, slip op. at 13–14 n.18.

Plaintiffs' second Due Process argument is equally without merit. As the Court stated in *Seagram v. Hostetter*,

> "The mere fact that state action may have repercussions beyond state lines is of no judicial significance so long as the action is not within that domain which the Constitution forbids." *Osborn v. Ozlin*, 310 U.S. 53, 62 (60 S.Ct. 758, 761, 84 L.Ed. 1074) [(1940)].

Id., 384 U.S. at 43, 86 S.Ct. at 1260.

This quotation, and the holding in *Seagram* itself, leaves no doubt that Connecticut's statute does not violate the Due Process Clause.[56]

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[84] Even assuming that the statute did violate the Sherman Act, it might be protected under the immunity doctrine of *Parker v. Brown*, 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315 (1943). *See Serlin v. Healy*, 512 F.Supp. 936, 942 (D.Conn. 1981), *aff'd sub nom. Morgan v. Div. of Liquor Control*, at 356 (2d Cir. 1981).

[85] USBA's *Brief* on Pre. Inj. at 51–52.

D. *Twenty-first Amendment*

[16, 17] Plaintiffs' last argument is that the price affirmation statute impermissibly infringes on the twenty-first amendment powers of the bordering states.[57] The short response to this claim is twofold. "First plaintiff[s] ha[ve] no standing to litigate the claims of other states. *Warth v. Seldin*, 422 U.S. 490, 499 [95 S.Ct. 2197, 2205, 45 L.Ed.2d 343] (1975)." *United States Brewers Ass'n v. Healy*, slip op. at 13 n.18. Second, even if plaintiffs did have standing, the claim is without merit, having been resolved by the Court in *Seagram*. It stated:

> As part of its regulatory scheme for the sale of liquor, New York may constitutionally insist that liquor prices to domestic wholesalers and retailers be as low as prices offered elsewhere in the country.

Id., 384 U.S. at 43, 86 S.Ct. at 1260.

Since the Connecticut statute does no more than insist that beer prices to its wholesalers be as low as prices offered to wholesalers in the bordering states, it clearly fits within the constitutionally permissible domain outlined in *Seagram*. Accordingly, plaintiffs' twenty-first amendment claim must also be rejected.

E. *Conclusion*

In conclusion, Connecticut's beer price affirmation statute does not violate the Commerce Clause since it neither discriminates against interstate commerce nor imposes an impermissible burden upon such commerce. Nor does the statute compel a violation of section one of the Sherman Act, since it requires only unilateral conduct by the brewers and importers.

Accordingly, plaintiffs' motion for summary judgment is denied, and defendants' cross-motion for summary judgment is granted.

SO ORDERED.

Adolph KIZAS, et al., Plaintiffs,

v.

William H. WEBSTER, et al., Defendants.

Civ. A. No. 78-983.

United States District Court,
District of Columbia.

Feb. 18, 1982.

Employees of Federal Bureau of Investigation brought action claiming that defendants' termination of program whereby they received preferential consideration for jobs as special agents with FBI was taking of private property without just compensation in violation of the Fifth Amendment. The District Court, Oberdorfer, J., held that for termination of program, plaintiffs were entitled to recover their reliance losses and reliance expenditures which included lost wages, as well as any expenses of moving to their jobs at the FBI, less any tax savings enjoyed with respect to moving expenses.

Order entered.

Eminent Domain ⚷302

For termination of program whereby clerical employees of the Federal Bureau of Investigation received preferential consideration for jobs as special agents with the

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[56] Plaintiffs' citation to *Fidelity & Deposit Co. v. Tafoya*, 270 U.S. 426, 46 S.Ct. 331, 70 L.Ed. 664 (1926) is inapposite. There New Mexico imposed sanctions for conduct which occurred outside the state. *Id.* at 433–35, 46 S.Ct. at 332. The Connecticut statute, in contrast, does not regulate conduct in another state, since it is the affirmation *in* Connecticut which is the focus of the statute. These cases are thus easily distinguishable.

[57] USBA's Brief on Pre.Inj. at 53–54.

Attachment 2

NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

THE PACKAGE SHOP, INC., and SHALBOR, INC., t/a BUTLER'S LIQUOR STORE, on behalf of themselves and all others similarly situated,

Plaintiffs,

v.

ANHEUSER-BUSCH, INC., CROWN BEER DISTRIBUTORS, INC., GARDEN STATE BEVERAGE CO., HARRISON BEVERAGE CO., HIGH GRADE BEVERAGE t/a MINE HILL DISTRIBUTING COMPANY or HIGH GRADE MINE HILL, HUB BEER DISTRIBUTORS, HUB CITY DISTRIBUTORS, INC., KONRAD BEER DISTRIBUTORS, INC., THE KRISTEN DISTRIBUTING CO., MS&W DISTRIBUTORS, INC., POINT PLEASANT DISTRIBUTORS, INC., RITCHIE & PAGE DISTRIBUTING CO., INC., SOUTH JERSEY DISTRIBUTORS CORP., TRIP DISTRIBUTORS, INC., and WARREN DISTRIBUTING CO.,

Defendants.

Civil Action No. 83-0513

OPINION

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DEBEVOISE, District Judge

I. INTRODUCTION

The second amended complaint in this action, brought under Section 1 of the Sherman Act, 15 U.S.C. § 1, *et seq*., and the New Jersey Antitrust Act, N.J.S.A. 56:9-1, *et seq*., alleges a horizontal conspiracy to allocate exclusive distributor territories among the wholesalers of Anheuser-Busch ("A-B") and Miller Brewing Company ("Miller") malt beverage products in the

State of New Jersey. Plaintiffs represent a certified class of New Jersey beer retailers. Defendants are distributors engaged in the business of selling A-B or Miller beer at wholesale to the plaintiff class of New Jersey retailers. The defendants which sold A-B beer are A-B/Newark; Crown Beer Distributors, Inc. ("Crown Beer"); Harrison Beverage Co. ("Harrison"); High Grade Beverage ("High Grade"); Konrad Beer Distributor, Inc. ("Konrad"); and Ritchie & Page Distributing Co., Inc. ("Ritchie & Page") (collectively referred to as "the A-B defendants"). Other than A-B/Newark, which is part of and operated by the Wholesale Operations Division of Anheuser-Busch, Inc., a Missouri corporation ("A-B/St. Louis"), the A-B defendants are all incorporated in New Jersey. The defendants which sold Miller beer are Garden State Beverage Co. ("Garden State"); Hub Beer Distributors, Inc. ("Hub Beer"); Hub City Distributors, Inc. ("Hub City"); The Kristen Distributing Co. ("Kristen"); MS&W Distributors, Inc. ("MS&W"); Point Pleasant Distributors, Inc. ("Point Pleasant"); South Jersey Distributors Corp. ("South Jersey"); Trip Distributors, Inc. ("Trip"); and Warren Distributing Co. ("Warren") (collectively referred to as "the Miller defendants").

The A-B defendants and the Miller defendants each jointly move for summary judgment.

II. PROCEDURAL BACKGROUND

Plaintiffs commenced this action in February 1983 by verified complaint against 70 malt beverage brewers and wholesale distributors alleging three separate categories of conspiracies to allocate territories and customers for the sale of beer at wholesale in New Jersey: 1) a horizontal conspiracy among the brewers; 2) a horizontal conspiracy among the distributors; and 3) vertical conspiracies among the brewers and their respective distributors.

After extensive class action discovery plaintiffs amended their complaint, dismissing more than half of the original defendants (26 distributors and 13 brewers) and adding A-B/Newark as a distributor defendant. On September 25, 1984, I denied plaintiffs' motion for class certification, concluding that the necessity for individualized rule-of-reason analyses as to the vertical territorial restraints and the lack of common proof of antitrust impact precluded class treatment. Plaintiffs subsequently filed a second motion for certification of the same retailer class on purely horizontal claims against only the A-B and Miller distributors. On March 12, 1985, I granted plaintiffs' second motion for class certification and dismissed all brewer defendants and the remaining distributor defendants which did not sell A-B or Miller beer.

On March 25, 1985, plaintiffs filed their Second Amended Verified Class Action Complaint and Demand for Jury Trial, in which plaintiffs allege:

> The defendants have combined, conspired and agreed among themselves to allocate territories for the distribution of beer in the relevant geographic market, i.e., the State of New Jersey. Defendants' conduct is manifested in a system of "areas of responsibility" or "exclusive territories" by which defendants allocate the distribution of beer in New Jersey. The purpose and effect of said system is that no distributor sells beer outside of that distributor's exclusive territory; no member of the plaintiff class can buy any brand of beer from a distributor other than the exclusive distributor for that brand of beer in the area in which the class member is located.

Plaintiffs' theory encompasses three distinct alleged horizontal conspiracies: 1) a conspiracy among the A-B distributor defendants to allocate territories for the sale of A-B beer; 2) a conspiracy among the Miller distributor defendants to allocate territories for the sale of Miller beer; and 3) a joint conspiracy between the A-B and Miller defendants to allocate A-B and Miller territories.

The complaint alleges that the defendants' conspiracies had the purpose and effect of eliminating intrabrand and interbrand competition among the defendant distributors in the State of New Jersey. The complaint further asserts that defendants' conduct was intended to and has indeed directly and proximately caused the wholesale prices of beer in New Jersey to rise to artificially high levels, and, as a result, members of the plaintiff retailer class have been required to pay higher prices for the beer they have purchased and continue to purchase from the defendant distributors. Plaintiffs seek judgment for, inter alia: 1) treble damages, interest, costs of suit and attorneys' fees, and 2) a permanent injunction ordering the termination of any and all geographic market allocation and exclusive territory agreements among the defendants.

III. LEGAL AND FACTUAL FRAMEWORK

For at least 20 years prior to 1967 A-B/St. Louis assigned specified territories within which each of its New Jersey distributors were authorized to sell A-B malt beverage products. However, in 1967 the Supreme Court held that the vertical imposition of exclusive territories was per se illegal. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967). Under cases interpreting the scope of the per se rule enunciated in Schwinn, producers could not insist upon observance of territorial or customer restrictions on resale, but could assign territories within which distributors or retailers were expected to concentrate their primary marketing efforts. See, Janel Sales Corp. v. Lanvin Parfums, Inc., 396 F.2d 398, 406 (2d Cir.), cert. denied, 393 U.S. 938 (1968); Colorado Pump & Supply Co. v. Febco, Inc., 472 F.2d 637, 639-40 (10th Cir.), cert. denied, 411 U.S. 987 (1973); but cf. Hobart Brothers Co. v. Malcolm T. Gilliland, Inc., 471 F.2d 894 (5th Cir. 1973).

In 1974, A-B/St. Louis and each of the A-B defendants (and all 950 A-B distributors nationwide) entered into Anheuser-Busch Wholesaler Equity Agreements ("the 1974 A-B Equity Agreements"). The 1974 A-B Equity Agreements assigned each distributor a primary marketing area in which it was responsible for sales, service and merchandizing of A-B products. The first paragraph of the agreements provided:

> AREA OF PRIMARY RESPONSIBILITY:
>
> Wholesaler agrees to exercise its best efforts to promote, sell and service Anheuser-Busch's Products in the geographic area designated on Exhibit 1 as Wholesaler's primary market area. Wholesaler shall be primarily responsible for servicing retail accounts in its primary market area with Anheuser-Busch Products and will be expected to concentrate its efforts in that area. It is understood, however, that, unless required by state law, Anheuser-Busch does not assign exclusive areas and does not grant exclusivity to Wholesaler in its primary market area.

The agreements specified that each wholesaler was to direct its efforts "to achieve maximum market representation of Anheuser-Busch products in Wholesaler's primary market area." The agreements also required distributors to satisfy certain sales and merchandizing standards. Failure to satisfy these standards in its area of primary responsibility ("APR") was grounds for termination of a distributor's relationship with A-B/St. Louis.

In 1977, the Supreme Court overruled Schwinn and held that vertical imposition of exclusive territories is not illegal per se. Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). Under Sylvania, the legality of vertical restrictions is evaluated under a rule-of-reason analysis.

In December 1982, A-B/St. Louis entered into new agreements ("the 1982 A-B Equity Agreements") with each of its 950 wholesalers nationwide, including the New Jersey A-B wholesalers. The provisions of these agreements were identical for all A-B distributors (except where the territorial restrictions contained therein were prohibited by state law). Paragraph one of the agreements expressly provides for exclusive territories and states that a distributor is subject to termination if it engages in sales outside its exclusive territory. The 1982 A-B Equity Agreements are still in effect.

Miller began selling beer in New Jersey in the 1940's through existing distributors. Some of these distributors were then serving as distributors for other brewers who had already established territories for their distributors. Miller has assigned specific territories to all its distributors since it began doing business in New Jersey.

Prior to May 1983, Miller's contracts with its various distributors were different, each being entered into at a different time. The contracts of certain distributors allocated to each an "area of primary responsibility", while others specified a "territory." None of the contracts contained specific performance standards, yet each distributor's performance was subject to Miller's review. The contracts either required the generalized "best efforts" of the distributor or required the distributor to actively and aggressively market Miller beer within its defined territory.

Miller had various rights under the contracts to terminate them if the distributor's performance was unsatisfactory. Some were expressly terminable at will at any time, while several others had detailed termination provisions. None of the contracts restricted Miller's right to appoint another distributor in the same defined territory, and a number expressly set forth Miller's right to do so. Some expressly allowed Miller to "at any time, by written notice to Distributor, reduce Distributor's Area."

Miller's contract with defendant Kristen was slightly different from the others. In 1953, Miller and Kristen entered into a written distributorship agreement which provided in pertinent part:

> The Distributor is to (a) sell and promote the sale of Miller High Life and such other of Miller's products as Miller may elect to market in the foregoing territory to the satisfaction of Miller; ... and (g) not sell outside such territory or to other wholesalers without the prior written approval of Miller.

This territorial restriction was augmented by an allocation clause under which Miller was empowered to determine, in its sole discretion, the quantities of beer that it would supply to Kristen.

In May 1983, Miller entered into uniform distributorship agreements with its distributors nationwide, including the nine New Jersey Miller defendants. These agreements identify the distributors' territories as exclusive and prohibit sales outside of the distributors' designated territories. The agreements are still in effect.

IV. PRELIMINARY RULINGS

The A-B and Miller defendants each jointly contend that there is no evidence to support plaintiffs' claims regarding a joint A-B/Miller conspiracy. In their papers in opposition to defendants' summary judgment motions, plaintiffs acknowledge that they are not pursuing the joint conspiracy claims, having "concluded that the conspiracies among Anheuser-Busch distributor defendants and among Miller distributor defendants are separate." Accordingly, defendants are entitled to summary judgment on the previously alleged joint A-B/Miller conspiracy claims.

In addition, plaintiffs have not attempted to prove the existence of separate A-B distributor and Miller distributor conspiracies nor calculate damages for the time periods following the contractual imposition of exclusive territories in the 1982 A-B Equity Agreements and the 1983 Miller Distributor Agreements. Plaintiffs effectively concede that the relevant time period with regard to its conspiracy claims against the A-B defendants is February 15, 1979 (i.e., four years prior to the filing of their original complaint) through December 1982, and February 15, 1979 through May 1983 with regard to their claims against the Miller defendants. To the extent that plaintiffs' second amended complaint seeks damages arising from activities of the A-B and Miller defendants after these respective time periods, summary judgment is granted in favor of defendants. Insofar as plaintiffs are no longer claiming that any existing territorial arrangements are illegal, defendants are similarly entitled to summary judgment on plaintiffs' claims for a permanent injunction.

V. DISCUSSION

Section 1 of the Sherman Act outlaws "[e]very contract, combination ..., or conspiracy, in restraint of trade ...." 15 U.S.C. § 1. To recover for a violation of Section 1, plaintiffs have the burden of proving three essential elements: 1) an unlawful conspiracy among defendants in restraint of trade; 2) anticompetitive injury to plaintiffs proximately caused by defendants' illegal conduct; and 3) measurable damages which plaintiffs have sustained. American Bearing Co. v. Litton Industries, 729 F.2d 943, 948 (3d Cir.), cert denied, 469 U.S. 854 (1984). Defendants move for summary judgment on each of the above elements.

A. Proof of Conspiracy

On its face, § 1 of the Sherman Act appears to bar any commercial agreement so long as it is "in restraint of trade." However, it has long been established that courts will not enforce the literal terms of § 1:

> "[R]estraint is the very essence of every contract; read literally, § 1 would outlaw the entire body of private contract law.

National Society of Professional Engineers v. United States, 435 U.S. 679, 687-88 (1978). In lieu of the narrowest reading of § 1, the Supreme Court early on adopted a "rule-of-reason" analysis under which challenged business relationships are evaluated to determine whether they are "unreasonably restrictive of competitive conditions." Standard Oil Co. v. United States, 221 U.S. 1, 58 (1911). Over time, the Supreme Court has identified certain "agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." Northern Pacific Railway Co. v. United States, 356 U.S. 1, 5 (1958). As the Supreme Court stated in United States v. Topco Associates, 405 U.S. 596, 608 (1972);

> One of the classic examples of a per se violation of § 1 is an agreement between competitors at the same level of the market structure to allocate territories in order to minimize competition.

Plaintiffs allege that the A-B defendants and Miller defendants separately conspired to enter just such agreements.

There are certain unique factual and analytical idiosyncrasies which distinguish this case from others brought under § 1 of the Sherman Act. Antitrust conspiracy cases typically require a determination as to whether the challenged business conduct resulted from an illegal horizontal agreement or from the independent business judgment of the defendants. See e.g., First National Bank v. Cities Service Co., 391 U.S. 253 (1968); Theatre Enterprises v. Paramount Film Distributing Corp., 346 U.S. 537 (1954). It is axiomatic that "Section 1 of the

Sherman Act prohibits only joint action; independent business decisions and actions cannot be the basis of a section 1 claim." Schoenkopf v. Brown & Williamson Tobacco Corp., 637 F.2d 205, 207 (3d Cir. 1980). In the present case defendants posit a third alternative explanation for their challenged conduct. The A-B defendants do not dispute that they did not compete with other wholesalers of the same brand of beer for retail accounts during the relevant damage periods. Indeed, it is agreed that there was a total absence of intrabrand competition among the A-B defendants wholesalers during the pertinent period. The A-B defendants contend that they confined their sales to their respective APRs or otherwise refrained from intrabrand competition with other wholesalers out of compliance with the corporate policies of A-B/St. Louis. While the Miller defendants do not concede the absence of intrabrand competition among New Jersey distributors of Miller beer products, they similarly assert that to the extent they did refrain from engaging in sales outside their APRs they did so in response to vertical direction from Miller.

Defendants assert that as early as the 1940's and continuing through to the present both Miller and A-B/St. Louis had strong corporate policies that their distributors not sell beer outside their assigned territories; that prior to the Schwinn decision the brewers vertically imposed exclusive territories on distributors of their beer nationwide; that after the Schwinn decision the brewers continued to emphasize to their distributors the importance of confining sales to their assigned territories; that the language of the agreements between the brewers and defendant wholesalers in effect prior to execution of the 1982 A-B Equity Agreements and the 1983 Miller Distributor Agreements reflected the continuing policy and expectation of the brewers that defendants confine their sales efforts to their assigned territories; and that defendants were fully aware of the brewers policies and expectations regarding out-of-territory sales. Defendants further contend that maintaining good relations with the brewers was critical to the long-term survival and success of the distributors' businesses; that with the exception of defendant Warren, whose sales of Miller beer represented approximately 50% of its total sales between 1979 and 1982, sales of either A-B or Miller beer products represented the vast majority (80% or more) of the sales of each of the defendant distributors; and that in addition to being defendants' major suppliers of beer, the brewers provided defendants with other substantial assistance which was important to the success of the defendants' businesses, including the extension of credit, assistance and instruction in marketing and merchandizing the brewers' products, and the allocation of point of sale materials such as clocks and neon signs. Defendants additionally assert that the very existence of the distributors as viable entities depended upon the brewers' continued favorable evaluation of the distributors' performance; that the brewers evaluated the performance of their distributors solely on the basis of the distributors' efforts within their assigned territories; that either A-B/St. Louis or Miller could terminate its relationship with a distributor if, in the brewer's judgment, the distributor was failing to satisfy its sales, servicing and promotional obligations within its assigned territory; and that the brewers could take other unilateral actions against a distributor, short of termination, for failing to adhere to the brewers' corporate policies and performance standards. Their actions, defendants contend, could effectively destroy a distributor's business, including withholding credit, restricting a distributor's allocation of beer, and/or appointing another distributor to service an existing distributor's territory. Lastly, defendants assert that each distributor had enormous investments in time, money and goodwill in being an A-B or Miller distributor; that each distributor understood that its long-term relationship with either A-B/St. Louis or Miller could be jeopardized by engaging in out-of-territory sales in contravention of the brewer's corporate policy; and that each distributor made a separate and independent business judgment that the short-term profits, if any, to be derived from out-of-territory sales were not worth the risk of losing its franchise to sell Miller or A-B beer. In short, defendants contend that restraints on intrabrand competition were the result of vertical direction from A-B/St. Louis and Miller, and not, as plaintiffs allege, the result of separate horizontal agreements between the A-B distributor defendants and the Miller distributor defendants.

As previously noted, plaintiffs abandoned their claims of unlawful vertical conspiracies between individual brewers and their respective distributors following the September 25, 1984 opinion denying plaintiffs' first motion for class certification. Therefore, the legality of vertical restraints on intrabrand competition is no longer an issue in this case. To the extent that there existed such brewer-initiated vertical restraints, no conclusions can be drawn with regard to the reasonableness of these restraints. Indeed, absent a finding that vertical restraints on intrabrand competition at the wholesale level are unreasonably restrictive of competitive conditions, any such restraints must be presumed lawful for purposes of the present motions.[1] Thus, in opposing defendants' motions for summary judgment, plaintiffs are placed in the ironic position of challenging the existence of vertical restraints on competition which had been the centerpiece of their antitrust allegations in the original complaint.

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[1] In rejecting the per se rule of Schwinn and reverting to a rule-of-reason analysis of vertical restrictions on competition, the Sylvania Court acknowledged that such restrictions can have procompetitive effects:

> Vertical restrictions promote interbrand competition by allowing the manufacturer to achieve certain efficiencies in the distribution of his products.

433 U.S. at 54. In Assam Drug Co., Inc. v. Miller Brewing Co., Inc., 798 F.2d 311 (8th Cir. 1986), the court upheld the validity of the vertical territorial assignments contained in the 1983 Miller Distributor Agreements under a rule-of-reason analysis.

In order to prevail on their motions for summary judgment, defendants must establish that "there is no genuine issue as to any material fact and that [they are] entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). As the Supreme Court stated in Celotex Corp. v. Catrett, ___ U.S. ___, 106 S. Ct. 2548, 2553 (1986):

> [A] party seeking summary judgment always bears the initial responsibility of informing the district court of the basis of its motion, and identifying those portions of "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any," which it believes demonstrate the absence of a genuine issue of material fact.

In order to satisfy their initial burden under Rule 56(c) in a case involving claims of illegal conspiracy under § 1 of the Sherman Act, it may be sufficient for defendants to present evidence reflecting their denial of the existance of or complicity in the alleged conspiracy and setting forth an innocent explanation of the challenged conduct. See e.g., Kreuzer v. Am. Academy of Periodontology, 735 F.2d 1479, 1488 (D.C. Cir. 1984).

In their moving papers, defendants have established beyond dispute that A-B/St. Louis and Miller assigned territories to their New Jersey distributors and that the distributors largely confined their sales to retail accounts within these territories. Officers of A-B/St. Louis and Miller testified in depositions that A-B/St. Louis and Miller had strong corporate policies favoring the exclusivity of the territories assigned to their respective distributors and that they communicated these policies to their distributors. Defendants have each categorically denied that they were party to or knew of any agreement among A-B or Miller distributors respecting the allocation of exclusive territories. Principals and/or officers of the A-B and Miller distributor defendants have uniformly stated under oath in depositions or certified in answers to interrogatories that they were aware of the A-B or Miller policies against out-of-territory sales, and limited sales to their respective territories, to the extent that they did, because they did not want to jeopardize their relationship with the brewers. This evidence satisfies the initial burden placed on moving parties under Rule 56(c).

Once the moving party has carried its burden under Rule 56, "its opponent must do more than simply show that there is some metaphysical doubt as to the material facts." Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp., ___ U.S. ___, 106 S. Ct. 1348, 1356 (1986). In the antitrust context, a plaintiff opposing a summary judgment motion must set forth specific facts showing a genuine issue of material fact as to whether defendants entered into an illegal conspiracy. Id. "[T]he inferences to be drawn from the underlying facts ... must be viewed in the light most favorable to the party opposing the motion." Id. at 1357, quoting from United States v. Diebold, Inc., 369 U.S. 654, 655 (1962). However, the Matsushita Court explained that in evaluating the evidence presented, "[w]here the record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, there is no 'genuine issue for trial.'" 106 S. Ct. at 1356.

Plaintiffs in this case have presented no direct evidence of a horizontal conspiracy among the A-B defendants or the Miller defendants to restrain intrabrand competition. That is, there is no evidence of meetings, telephone calls or correspondence among the A-B or Miller defendants during or in which they discussed the allocation of exclusive territories.

In the absence of direct evidence of agreement among the defendants, a conspiracy can be established by circumstantial evidence sufficient to permit an inference of agreement.[2] Interstate Circuit, Inc. v. United States, 306 U.S. 208, 221 (1939). As the Third Circuit explained in Milgram v. Loew's, Inc., 192 F.2d 579, 583 (3d Cir. 1951):

> [I]n this modern era of increasing subtleties, it is rare indeed for a conspiracy to be proved by direct evidence. There is no dispute over the proposition that circumstantial evidence will sustain a finding of conspiracy.

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[2] In most contexts, attempts to distinguish between so-called direct and circumstantial evidence result in essentially arbitrary classifications. All evidence falls somewhere along a continuum between the irrelevant and the conclusive. Some evidence is simply more probative of a particular matter to be proved than other evidence. The distinction between direct and circumstantial evidence in antitrust law, however, has taken on a particularized meaning. Therefore, for purposes of the present motions, references to direct evidence relate to oral or written communications in which defendants expressly discussed the creation or maintenance of exclusive territories. References to circumstantial or indirect evidence relate to all other evidence which tends to either prove or disprove the existence of such a horizontal conspiracy.

There are, however, legal limits on the inferences which may be drawn from circumstantial evidence; "limits beyond which reasonable inference-drawing degenerates into groundless speculation." In re Japanese Electronic Products, 723 F.2d 238, 304 (3d Cir. 1983), rev'd on other grounds, Matsushita, supra.

The Supreme Court in Matsushita specifically cautioned that "antitrust law limits the range of permissible inferences from ambiguous evidence in a § 1 case." 106 S. Ct. at 1357. In particular, the Court stated that evidence of "conduct as consistent with permissible competition as with illegal conspiracy does not, without more, support even an inference of conspiracy." Id. at 1362, n.21; see also, Id. at 1357. Such evidence lacks any tendency to make the existence of the ultimate fact in issue (i.e., a horizontal conspiracy) more probable, and therefore does not give rise to a 'genuine issue for trial.'

The Supreme Court decision in First National Bank v. Cities Service Co., 391 U.S. 253 (1968) is instructive on this point. In Cities Service the plaintiff alleged that a number of oil company defendants had conspired to boycott the purchase of Iranian crude oil through him. Defendant Cities Service initially had negotiated with the plaintiff but ultimately purchased no oil through him despite the favorable terms of his offer. In opposition to a motion by Cities Service for summary judgment, plaintiff argued that the failure of Cities Service to purchase Iranian oil through him despite his attractive offer supported a reasonable inference of participation in a conspiracy sufficient to raise a question of fact for trial. The Supreme Court affirmed summary judgment against the plaintiff holding that

> not only is the inference that Cities' failure to deal was the product of factors other than conspiracy at least equal to the inference that it was due to conspiracy, thus negating the probative force of the evidence showing such a failure, but the former inference is more probable.

391 U.S. at 280.

In Matsushita, the Court further articulated the quality of evidence necessary to support a reasonable inference of conspiracy:

> To survive a motion for summary judgment or for a directed verdict, a plaintiff seeking damages for a violation of § 1 must present evidence "that tends to exclude the possibility" that the alleged conspirators acted independently.

106 S. Ct. at 1357, quoting from Monsanto Co. v. Spray Rite Service Corp., 465 U.S. 752, 764 (1984). This does not mean, as the Miller defendants argue, that the district court should usurp the function of the jury by determining on summary judgment whether the inference of conspiracy is more probable than not. Rather, the court must examine the totality of the circumstantial evidence to determine whether there is sufficient unambiguous evidence from which a rational jury could make such a finding without resorting to rank speculation. See e.g., Edward J. Sweeney & Sons, Inc. v. Texaco, Inc., 637 F.2d 105, 116 (3d Cir.), cert. denied, 451 U.S. 911 (1981).

Applying the Matsushita standard to the facts in this case is particularly problematic. The central issue in this case is whether restraints on intrabrand competition resulted from vertical direction from the brewers or horizontal agreement among defendant distributors of the A-B or Miller brands. The existence of vertical restraints on intrabrand competition among New Jersey beer wholesalers does not necessarily exclude the possibility that illegal horizontal restraints were simultaneously operating to restrict such competition. Restraints on intrabrand competition might plausibly be the result of both vertical direction from the brewers and horizontal agreement among the distributors. However, under the Matsushita summary judgment standard, plaintiffs have the burden of presenting a minimum quantum of unambiguous circumstantial evidence from which a jury could reasonably infer that the conduct which forms the basis of plaintiffs' § 1 claim (that is, the decision of A-B and Miller wholesalers to refrain from intrabrand competition in New Jersey) resulted from horizontal agreement among the wholesalers and not from independent business judgments on the part of each distributor to abide by the corporate policy of A-B/St. Louis or Miller. In other words, plaintiffs must present evidence which favors the inference that defendants were acting in conformity with a horizontal conspiracy not to compete and "tends to exclude the possibility" that they were merely responding to the vertical direction of the brewers. Matsushita, supra, 106 S. Ct. at 1357. Evidence of conduct which is equally consistent with brewer-initiated vertical restraints as with an illegal horizontal conspiracy will not suffice to create a triable issue for a jury. Id.

In lieu of direct evidence of conspiracy, plaintiffs rely on circumstantial evidence of consciously parallel business behavior to establish the existence of horizontal agreements among the A-B defendants and the Miller defendants. As the Supreme Court noted in Theatre Enterprises, "business behavior is admissible circumstantial evidence from which the fact finder may infer agreement." 346 U.S. at 540. Under the theory of conscious parallelism, a plaintiff must show 1) that the defendants' business behavior was parallel, and 2) that the defendants were conscious of each other's conduct and that awareness was an element in their decisional process. Schoenkopf, 637 F.2d at 208.

While having some tendency suggestive of concert of action, consciously parallel conduct standing alone is insufficient circumstantial evidence from which to infer an antitrust violation. Bogosian v. Gulf Oil Corp., 561 F.2d 434, 446 (3d Cir. 1977), cert. denied, 434 U.S. 1086 (1978). Before such an inference may be drawn a plaintiff must also show 1) that the defendants acted in contradiction of their economic interests, and 2) that the defendants had a common motive to enter into an agreement. Venzie Corp. v. United States Mineral Products Co., Inc., 521 F.2d 1309, 1314 (3d Cir. 1975). Furthermore, in order to survive a summary judgment motion under the standard articulated in *Matsushita*, *supra*, the circumstantial evidence offered by plaintiffs to satisfy the above four elements of proof must "make the inference of rational, independent choice less attractive than that of concerted action." *Bogosian*, 561 F.2d at 446.

1. *Circumstantial Evidence of an A-B Distributor Conspiracy*[3]

a. *Parallel Conduct*

There is no dispute that the A-B defendants made virtually no sales of A-B beer outside their brewer-assigned APRs during the relevant period. Indeed, there is no evidence that A-B/Newark, Crown or Harrison ever sold A-B beer outside of their respective APRs. Certainly, to the extent that defendants confined their sales to the territories assigned to them by A-B/St. Louis, this parallel conduct is perfectly consistent with the inference that restraints on intrabrand competition were vertically directed.

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[3] In support of their conspiracy claims, plaintiffs rely extensively on deposition testimony of the defendants relating to the conduct of individual distributors. Before statements of alleged coconspirators may be admitted against other purported members of the conspiracy, plaintiffs must establish by a preponderance of independently admissible evidence the existence of the conspiracy and that each party against whom the statements are offered was a member of it. *See In re Japanese Electronic Products*, 723 F.2d 238, 260-263 (3d Cir. 1983), *rev'd on other grounds*, *Matsushita*, *supra*. At the hearing on the present summary judgment motions, plaintiffs' counsel made a proffer as to the independent evidence plaintiffs will rely on to establish the participation of each defendant in the alleged horizontal conspiracies.

Plaintiffs cite evidence of certain isolated instances in which particular A-B distributors sold A-B beer outside their APRs, and argue that this evidence supports the inference that territories were established by horizontal agreement among the wholesalers and not by vertical direction from the brewers. Plaintiffs have presented evidence of only three such instances.

Plaintiffs note that High Grade sold A-B beer to a retail account known as Witty's Rahway during the entire period covered by its 1974 Equity Agreement with A-B/St. Louis notwithstanding the fact that Witty's Rahway was located in the APR of A-B/Newark. Plaintiffs argue that High Grade's out-of-territory sales to Witty's Rahway and A-B/Newark's acquiescence in these sales demonstrate that the wholesalers were allocating retail accounts among themselves in apparent disregard of the brewer-assigned territories. The record, however, does not support such a conclusion. High Grade began selling to Witty's Rahway as an apparent accommodation to its then owner who also owned two other retail stores within High Grade's APR and who derived the benefit of quantity discounts by purchasing A-B beer for all three establishments from one wholesaler. These facts simply are not suggestive of a conspiracy among A-B wholesalers to allocate exclusive territories.

Plaintiffs also cite evidence that Konrad serviced 17 retail accounts along Route 73 in Mt. Laurel Township in southern Burlington County which were located in the APR assigned to Ritchie & Page in its 1974 Equity Agreement with A-B/St. Louis.

In 1975, Ritchie & Page inquired of A-B/St. Louis as to whether it should service two new accounts in this area. Apparently, Ritchie & Page did not challenge Konrad's right to sell A-B beer to the 15 other accounts that Konrad was already servicing in the area. In a letter to Konrad and Ritchie & Page dated April 30, 1975, A-B/St. Louis stated that "we have no right, nor do we assume the right to settle your area dispute." Plaintiffs contend that this language confirms that exclusive territories were not vertically directed. A careful reading of the entire letter, however, belies this contention.

The April 30, 1975 letter is clearly crafted to avoid the appearance of imposing exclusive territories on its distributors in violation of the antitrust standard set forth in the Schwinn decision. The final paragraph of the letter reminds the distributors that "the law does not allow exclusivity, and Anheuser-Busch, Incorporated cannot and will not undertake any action which could be interpreted as advocating exclusivity." Nevertheless, in preceding passages A-B/St. Louis notes that Konrad had been "servicing the area for a number of years" and expressed its satisfaction with the existing situation. The letter further states that A-B/St. Louis was prepared to delete the area from the APR of Ritchie & Page and add it to the APR of Konrad. Thus, while A-B/St. Louis purportedly refused to settle the "area dispute", its preference for maintaining the status quo was unequivocally communicated to the distributors. Furthermore, the very fact that Ritchie & Page appealed to A-B/St. Louis for a clarification of wholesaler territories undermines plaintiffs' claim of a horizontal conspiracy. If retail accounts were being allocated by agreement among the wholesalers, there would be no reason for any wholesaler to seek such a clarification from the brewer.

Plaintiffs further rely on evidence that Ritchie & Page serviced at least one active retail account in Allentown, New Jersey during the entire period of its 1974 Equity Agreement with A-B/St. Louis. Richard Woodruff, New Jersey District Manager for A-B/St. Louis, acknowledged in deposition testimony that during this period Allentown was situated in the APR of Crown.

Evidence that certain A-B wholesalers sold A-B products to retail accounts outside their brewer-assigned APRs without objection from the distributors in whose APRs these accounts were located has some tendency suggestive of horizontal agreement among the wholesalers. However, the probative force of the evidence presented by plaintiffs of such extra-territorial sales by A-B wholesalers is extraordinarily weak. This evidence reflects out-of-territory sales to no more than 20 of approximately 12,000 retail accounts in New Jersey. The majority of these accounts are located near the boundaries of the brewer-assigned wholesaler territories. The A-B defendants point out that A-B/St. Louis designated wholesaler APRs by cutting up a map of New Jersey and appending these map cut-outs as an exhibit to its 1974 and 1982 Equity Agreements with each New Jersey distributor. These cut-outs do not clearly delineate each municipality, street or highway situated in each distributor's territory. Thus, the fact that several wholesalers historically serviced a small number of retail accounts located along the boundary of their map areas which actually fell within the adjoining territory of another wholesaler can reasonably be attributed to the imprecision of the method by which A-B/St. Louis designated wholesaler territories. For example, in the 1982 Equity Agreement between A-B/St. Louis and Ritchie & Page the map cut-out of the distributor's APR included the town of Allentown but the map had been cut in such a way as to exclude the name of the town. In a letter to A-B/St. Louis dated September 28, 1982, Ritchie & Page sought to clarify that it had serviced the Allentown area since prior to 1963 and that the two accounts in that town were within its territory.

As further evidence of defendants' parallel business conduct arising out of the alleged horizontal conspiracy, plaintiffs cite to phone conversations between Louis Natale of Ritchie & Page and Herb Konrad of Konrad and other of the A-B defendants during the summer of 1982 relating to the sale of A-B beer in New Jersey by International Beverage Company ("International Beverage"). International Beverage was a so-called "transshipper" which obtained A-B and other brands of beer from sources in the State of New York and "transshipped" them to retailers located throughout New Jersey at prices lower than those of the defendants. Plaintiffs assert that Natale and

Konrad made these calls "to express their displeasure at discounted sales which they feared would cut into their monopoly prices." The record does not support this assertion.

Although Mr. Konrad acknowledged in deposition testimony that he was personally concerned that sales of A-B beer by International Beverage might cut into Konrad's sales, neither Mr. Konrad nor Mr. Natale recalled discussing International Beverages prices in their phone conversations with other A-B wholesalers. It is apparent from his deposition testimony that Mr. Konrad was concerned that International Beverage was not a brewer-authorized distributor of A-B beer and was therefor operating in violation of New Jersey alcoholic beverage law. In fact, Mr. Konrad testified that prior to contacting other wholesalers he called the Director of the New Jersey Division of Alcohol Beverage Control ("ABC") to report International Beverage's activities. According to Mr. Konrad, the ABC held hearings on the matter, and subsequently directed International Beverage to discontinue its sales of A-B beer in New Jersey. Mr. Natale testified that in his phone conversations with other A-B wholesalers he merely expressed his concern that International Beverage's sales might compromise the product quality of the A-B brand in New Jersey. Concern over the legality of International Beverage's activities and concern over the maintenance of A-B product quality are undeniably legitimate subjects of communication among the A-B defendants. At best, the evidence of phone conversations between the A-B defendants merely demonstrates an opportunity for formation of an unlawful conspiracy. Such evidence standing alone is insufficient to defeat summary judgment. Venzie, 521 F.2d at 1313. Furthermore, as the Third Circuit noted in Venzie:

> While the jury [would be] free to disregard the defendants' testimony that no agreement of any kind was formulated during the course of these contacts, mere disbelief could not rise to the level of positive proof of agreement to sustain plaintiffs' burden of proving conspiracy.

Id.

b. Knowledge of Parallel Conduct

There is no dispute that each of the A-B defendants knew that the other A-B wholesalers in the state were limiting sales to particular territories. They were each familiar with the boundaries of neighboring territories, aware that they had none of the same customers for A-B beer as any other A-B wholesaler, and fully expected that the other A-B wholesalers would not attempt to compete for customers within another wholesaler's territory. Defendants concede these facts and rightly observe that the same facts would be present whether the wholesalers were agreeing among themselves to restrict intrabrand competition or were merely abiding by the policy of A-B/St. Louis against extra-territorial sales.

Plaintiffs also cite evidence that defendants' business decisions were based on their knowledge that each A-B wholesaler would confine its sales of A-B products to particular territories. Plaintiffs note that the A-B defendants routinely exchanged beer among themselves at cost if one wholesaler did not have sufficient beer to meet retailer demand and another wholesaler had excess inventory to spare. Plaintiffs argue that a wholesaler would be unwilling to provide another wholesaler with beer at cost unless it was secure in the knowledge that the wholesaler to whom it gave the beer would not turn around and resell the beer to retailers in the territory of the wholesaler supplying the beer.

Plaintiffs further cite conversations between High Grade and other A-B wholesalers regarding High Grade's so-called "convenience sales" to retailers outside its APR when other distributors were closed for business or were otherwise unable to service the accounts. Mr. De Marco of High Grade testified that High Grade would attempt to contact the wholesalers in whose territories the retailers were located prior to or soon after making such sales. Plaintiffs argue that the implied purpose of these calls was to seek permission to make the sales or to disclaim any intent to invade the neighboring wholesaler's territory, and that such calls would only be necessary if High Grade were party to a horizontal agreement to honor the exclusive territories of neighboring wholesalers. This argument, however, finds no support in the record. In fact, Mr. De Marco unequivocally testified that the purpose of the calls was to inform the neighboring distributor that a retailer in its territory was experiencing an inventory shortage.

While evidence of the exchange of beer at cost among the A-B defendants and High Grade's convenience sales to retailers outside its APR tends to show that the A-B defendants recognized and respected the exclusivity of each other's territories, this conduct does not favor the inference of a horizontal conspiracy. Cooperation of this sort among A-B wholesalers for the purpose of assuring that retailers receive an uninterrupted supply of A-B beer is certainly in the interest of the brewer and is entirely consistent with a brewer-directed system of restraints on intrabrand competition. It may be true, as plaintiffs argue, that this level of cooperation among distributors would not exist in an unrestricted competitive environment. In such an environment a business enterprise might be expected to act decisively to exploit the inability of a competitor to adequately service its customers. This truism, however, does not advance plaintiffs' position. As previously stated, the question in this case is not whether defendants were operating in a truly competitive manner. Defendants concede the absence of competition among distributors of A-B beer, and evidence relating to the exchange of beer at cost and extra-territorial convenience sales merely highlights this admitted fact.

In sum, plaintiffs' evidence of defendants' parallel business conduct succeeds only in proving that which is uncontested. Plaintiffs have established that the A-B defendants uniformly and consciously refrained from competing among themselves for retail accounts. However, evidence of this parallel business behavior does nothing to assist plaintiffs in satisfying their burden under Matsushita.

c. Conduct Against Economic Self-interest

In a competitive business environment, a business enterprise is presumed always to act to further its self-interest. It logically follows that business behavior which is contrary to self-interest would be rational only if business entities which would otherwise be in competition with one another act in a similar manner. Thus, parallel action by putative competitors in apparent contradiction of their individual self-interest strengthens the inference of conspiracy. See, generally, Areeda, Antitrust Law ¶ 1415 (1986).

As evidence of conduct by the A-B defendants which was contrary to their individual self-interest, plaintiffs cite the distributors' refusal to make sales to retail accounts located outside their respective APRs when such sales would have required no incremental cost to the distributors or when the delivery costs of making such sales would have been no higher than the cost of sales to retail accounts within their APRs. In particular, plaintiffs note that four of the six A-B defendants (excluding Crown and A-B/Newark) engaged in the practice of "selective sales abstention" whereby the distributor would sell some brands of beer to certain retailers outside their A-B territories, yet refuse to sell A-B brands to the same retailers, even though the A-B brands were on the distributors' trucks when they were delivering the other brands. Under these circumstances, the sale of A-B brands to these retailers would have entailed no additional delivery costs to the distributors. Similarly, the fact that these four A-B distributors travelled beyond the boundary of their respective A-B territories to deliver other brands of beer demonstrates that the distance for profitably selling A-B brands extended beyond the A-B/St. Louis-assigned APRs. Plaintiffs also note that due to the irregular shape of the A-B territories there was substantial economic incentive for the A-B defendants to sell outside their APRs in areas that were closer to their warehouses than areas within their APRs. Furthermore, the existence of price differences among the various A-B defendants provided an even greater incentive for lower priced distributors to cross into the territories of higher priced distributors in order to increase sales. In addition, plaintiffs contend that the refusal by certain defendants to sell A-B brands to members of retail buying cooperatives ("co-ops") located outside their APRs even though the co-op drop site was within their APR and the practice of selling beer at cost to distributors with inventory shortages rather than taking advantage of their inability to service their retail customers by selling at a profit directly to the customers is further evidence of conduct which was contrary to the defendants' economic self-interest.

Plaintiffs assert that the refusal of defendants to sell A-B beer outside their A-B territories cannot be justified by inventory or capacity problems insofar as most of the defendants admit that they either had excess capacity during portions of the relevant time period or had in the past expanded their operations to meet any increase in sales they could obtain. In sum, plaintiffs charge that the failure of the A-B defendants to take advantage of profitable sales opportunities outside their APRs was demonstrably contrary to their self-interest and would be economically rational only if they had agreed among themselves to uniformly refrain from engaging in such extra-territorial sales.

While conceding that they could have derived short-term profits from certain sales of A-B brands outside their respective APRs, the A-B defendants insist that their refusal to engage in such sales is entirely consistent with their long-term economic interests. In particular, the A-B defendants contend that they would have risked losing their franchise to sell A-B beer by contravening the brewer's corporate policy against extra-territorial sales. Thus, their interest in maintaining a long-term relationship with A-B/St. Louis was of greater economic importance to them than any short-term profit they might have derived from sales of A-B beer outside of their respective territories. As Leonard Hollander of Harrison testified:

> I was restricted to stay in my marketing area and put all my efforts, all my promotions, all my merchandising within that area. Anheuser-Busch felt very strongly about a wholesaler taking care of his marketing area, or he could

> be -- even though the sales were up, if you did not do the merchandising, servicing the customers, selling, you were subject to be relieved as a wholesaler. And I, for one, was not going to test it.

Ralph Rapisardi of Crown similarly stated by way of affidavit:

> That practice [of limiting sales to the brewer-assigned territory] is strictly rooted in obedience to A-B corporate policy and sound business and marketing policy. There is no doubt in my mind that if Crown or any other distributor did not adhere to the directives of A-B or deviate[d] from the corporate policy of distributing beer only within assigned geographic territories, that distributor would risk losing its distributorship. The investment in an A-B distributorship is very substantial. I have never, and would never take the chance of losing my distributorship by selling outside my territory ... in complete disregard of the corporate policy of A-B which I have known since 1948.

Courts and commentators alike have concluded that evidence that defendants have merely forgone profitable business opportunities does not satisfy the required showing of conduct against self-interest when defendants have offered sound business reasons for their conduct. In Tose v. First Pennsylvania Bank, N.A., 648 F.2d 879, 895 (3d Cir.), cert. denied, 454 U.S. 893 (1981), the Third Circuit stated:

> A business's refusal to enter a transaction, even a transaction with potential for a substantial profit, cannot support an inference that it acted in contradiction of its own economic interests in the face of substantial unrebutted and unimpeached evidence that its refusal was consistent with its own best interests.

See also, Venzie, 521 F.2d at 1314-15. In his treatise on antitrust law, Prof. Areeda cautions that courts "must not characterize a firm's sacrifice of short-run interest in favor of long-run interest as contrary to its self-interest." Areeda, supra, at ¶ 1415e. Of particular relevance to this case, Prof. Areeda highlights "the possibility that one might refrain from taking an otherwise profitable step because someone else has the power to make it unacceptably costly ... Because the pain that another party can inflict exceeds the gain from doing what the actor would otherwise like to do, inaction serves his self-interest." Id. at ¶ 1415f; see also, Cities Service, 391 U.S. at 278-79.

Plaintiffs argue that the A-B defendants' claim that their long-term economic interests were best served by complying with the policy of A-B/St. Louis favoring territorial exclusivity finds no evidentiary support in the record and merely serves as a pretext for an illegal horizontal conspiracy. There is no question that an antitrust defendant's assertion that its conduct was intended to advance its own economic interests without regard to whether its competitors acted in a similar manner should not be accepted on faith. See e.g., Milgram, 192 F.2d at 584-85. Prof. Areeda notes that "[i]f the defendant thought that his behavior served his own interests without regard to the behavior of others, the tribunal has a complete explanation for his conduct and thus no occasion to search for the other explanation of conspiracy." However, he is quick to point out that the self-interest issue does not turn on self-serving statements of a defendant's professed state of mind. "Of course, an incredible claim of self-interest need not be believed." Areeda, supra. at ¶ 1415b.

The credibility of a defendant's claim of self-interest largely depends on the factual circumstances which gave rise to the challenged conduct. In practice those courts which have rejected conspiracy claims in part because the challenged conduct was consistent with a defendant's independent economic interests have required at least some factual basis to support this conclusion. See, Cities Service, 391 U.S. at 278-79; Tose, 648 F.2d at 894-95. As a general rule, a conclusion that challenged conduct is the product not of a conspiracy but of an independent business decision consistent with a defendant's economic self-interest is fully warranted if the conduct in question appears to be a reasonable or rational response to a particular business situation or market condition.

In the present case, the validity or rationality of the independent business reason for their conduct proffered by the A-B defendants depends in large measure on the quality of evidence relating to three critical questions: 1) Did A-B/St. Louis have a corporate policy against sales by distributors of its beer outside their assigned APRs; 2) How effectively was this policy communicated to the A-B defendants, and 3) Was the defendants' purported fear of brewer sanctions for deviating from this policy justified under the circumstances?

There is no dispute that from the time it first began selling its products in New Jersey A-B/St. Louis has assigned specific sales territories to its New Jersey distributors. As will be developed below, the record firmly establishes that A-B/St. Louis has long maintained a corporate policy favoring the exclusivity of these territories. August A. Busch, III, Chairman and Chief Executive Officer of A-B/St. Louis, and Richard H. Woodruff, A-B/St. Louis' District Manager for New Jersey, each testified as to the precise nature of this policy and the importance of this policy to the brewer. In further support of their present joint summary judgment motion, the A-B defendants have submitted the affidavits of Ralph J. Rapisardi, President and General Manager of Crown, and Bernard F. McGarry, Sales Manager of Harrison, and the certification of Thomas J. Ryan, Chief Executive Officer of Ritchie & Page. Each of these individuals had been employed by A-B/St. Louis for many years prior to becoming affiliated with the distributors they now represent. At various times, they had each held key managerial positions with A-B/St. Louis in which they were responsible for monitoring the wholesale distribution and sales practices of distributors of A-B products in certain state, division, regional and/or national markets, and through which they each became intimately familiar with the overall marketing philosophy of A-B/St. Louis and its policy regarding the territories it designated to its distributors. Each categorically asserts in his affidavit or certification that the company policy of A-B/St.

Louis was that each A-B distributor should stay within its assigned territory and concentrate its efforts on maximizing the sale of A-B brands to retail accounts in that geographic area.

The long-standing nature of this policy is reflected in letters from A-B/St. Louis received by Harrison in 1956 when Harrison first became an A-B distributor and again in 1958 when it was assigned additional territory by A-B/St. Louis. Attached to each letter was a map which the letters described as "outlining exactly the territory you will service with Anheuser-Busch products." Dr. John Jordan, one of the economic experts retained by plaintiffs, acknowledged in deposition testimony that in this context "exactly" meant "just what the territory is." no more and no less. The territory assigned to Harrison has not changed since 1958, and there is no evidence that Harrison ever sold A-B products outside the territory assigned to it by A-B/St. Louis.

The existence of an A-B/St. Louis corporate policy favoring the exclusivity of distributor territories is most strikingly revealed in the marketing practices of A-B/Newark. By virtue of the fact that it was wholly owned and operated by A-B/St. Louis, the operating policies and practices of A-B/Newark were dictated directly by A-B/St. Louis through its Wholesale Operations Division. As employees of A-B/St. Louis, the A-B/Newark management was directed by A-B/St. Louis to adhere to company policy and confine its sales to the marketing area assigned to it by A-B/St. Louis. William Riesenbeck, a former

Eastern Region Manager of A-B/St. Louis' Wholesale Operations Division, testified that "[i]t's just a very strong policy of the company, you do not sell outside the territory, period." Raymond Arps, Marketing Manager of A-B/Newark, further explained during his oral deposition:

> A: ... it's not my decision to say whether we should have a policy or not. I'm an employee of the company. They have a corporate policy. I adhere to that policy. I don't get paid to make the decisions as to whether we should have that policy or shouldn't have it.
>
> Q: All right. Who does make the policy?
>
> A: The policy is Anheuser-Busch corporate.

Richard Woodruff, who was first hired by A-B/St. Louis in 1948 as a salesman for the predecessor of A-B/Newark, stated by way of affidavit that A-B/Newark has always followed the corporate policy of A-B/St. Louis and sold only within its marketing area. Plaintiffs have offered no evidence to contravert the above statements and testimony regarding the distribution practices of A-B/Newark and its adherence to A-B/St. Louis corporate policy.

In an effort to rebut the evidence offered by the A-B defendants relating to the A-B/St. Louis policy against extra-territorial sales by its distributors, plaintiffs cite to a single sentence drawn from paragraph 1 of the 1974 A-B Equity Agreements which states that "[i]t is understood ... that ... Anheuser-Busch does not assign exclusive areas and does not grant exclusivity to Wholesalers in its primary market area." Plaintiffs interpret this contractual language as reflecting the absence of a brewer policy favoring exclusivity. However, this interpretation is reasonable only if the balance of the provisions in the agreement are studiously ignored. The 1974 A-B Equity Agreement assigned each distributor a primary marketing area in which it was responsible for sales, service and merchandizing of A-B products. Exhibit 1 of the agreement was a map showing the distributor's assigned territory. Under paragraph 1, the distributor agreed "to exercise its best efforts to promote, sell and service" A-B products in this territory. Paragraph 1 further specified that the distributor "shall be primarily responsible for servicing retail accounts in its primary market area with Anheuser-Busch products and will be expected to concentrate its efforts in that area." Under paragraph 2, the brewer is committed only to supporting the distributor's "efforts to achieve maximum market representation of Anheuser-Busch Products in Wholesaler's primary market area." The agreement also required the distributor to satisfy certain broadly-defined Sales and Merchandizing Standards in its area of primary responsibility. Thus, while the 1974 A-B Equity Agreement does not expressly prohibit the distributor from selling outside its assigned territory, the entire document unmistakably conveys the brewer's desire and expectation that the distributor confine its sales activity to this territory.

Furthermore, the import of the contractual disclaimer of exclusivity relied on by the plaintiffs cannot be fully apprehended without viewing the 1974 A-B Equity Agreements in the context of applicable antitrust law in effect at the time these agreements were executed. The agreements were adopted by A-B/St. Louis when the Schwinn per se standard was in effect. Under Schwinn, A-B/St. Louis could not contractually impose exclusive sales territories on its distributors. 388 U.S. at 379. However, it could consistent with the narrow interpretation of Schwinn adopted by several courts of appeal assign territories within which its distributors would be expected to concentrate their primary marketing efforts, see e.g., Colorado Pump, 472 F.2d at 639-40, and arguably could by non-coercive means attempt to encourage and persuade the distributors not to sell outside these territories. The 1974 A-B Equity Agreement appears to reflect a calculated attempt by A-B/St. Louis to advance a strong policy preference for the exclusivity of distributor territories without overstepping the bounds of existing antitrust law.

There is also considerable evidence that A-B/St. Louis actively communicated its policy favoring exclusivity to distributors of its beer nationwide, and that the A-B defendant distributors in particular were fully aware of the brewer's policy.

As an initial matter, the A-B defendants uniformly believed that the 1974 A-B Equity Agreement clearly conveyed the brewer's policy and expectation that the distributors confine sales to their assigned territories. Herbert Konrad of Konrad testified:

> [I]f you look at the total document, the whole document points or focuses on your [area of primary responsibility]. So, ... I came to the conclusion that they did not want me to sell outside my [APR].

Leonard Hollander of Harrison similarly stated that he felt restricted by his equity agreement with A-B/St. Louis to stay in his assigned marketing area and put all his efforts, all his promotions, all his merchandizing within that area. In view of the contractual language emphasizing the importance of maximizing sales within their assigned territories, it was certainly not unreasonable for the A-B defendants to conclude that A-B/St. Louis expected them to confine their sales to these assigned areas.

There is also ample evidence that the policy preference reflected in the 1974 A-B Equity Agreements was reinforced by other oral and written communications. August Busch, III testified:

> [W]e would also say to these [New Jersey] wholesalers that Anheuser-Busch would think it would be a very bad practice, and we would frown upon servicing outside primary areas of responsibility.... We could not prevent wholesalers from doing it, ... under the law. But we would certainly strongly advise them not to do it ....

A memorandum from Mr. Busch to all A-B distributors dated October 13, 1981 confirmed that A-B/St. Louis was opposed to distributors selling A-B products outside their assigned areas and urged distributors to refrain from such sales. The memorandum further noted that this position had been communicated to the distributors "on a number of occasions in the past."[4] Richard Woodruff also testified that part of his duties as A-B District Manager for New Jersey included communicating to the A-B defendants the policy of A-B/St. Louis concerning areas of primary responsibility. He noted that he did not discuss the subject of extra-territorial sales with the A-B defendants on a regular basis because the distributors were complying with A-B//St. Louis policy and confining their sales to their respective APRs. Nevertheless, he stated that on those occasions when the issue did arise, "I would point out that our position was that we did not wish [the distributor] to sell out of his [area of] primary responsibility, that it was to his best interest to devote all his time and efforts in the area that was outlined by Anheuser-Busch."

Joseph DeMarco of High Grade testified that he interpreted his 1974 agreement with A-B/St. Louis as restricting High Grade from selling A-B products outside its assigned APR.[5]

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[4] Plaintiffs argue that this memorandum should be given little if any evidentiary weight insofar as each of the A-B defendants failed to produce this memorandum in response to specific document requests relating to any written communications from A-B/St. Louis regarding territorial restrictions. Plaintiffs contend that their failure to do so casts doubt on whether this memorandum was ever sent to or received by any of the A-B defendants in New Jersey. However, the failure of the A-B defendants to produce this document during discovery demonstrates only that they did not retain the memorandum in their files and does not overcome Busch's testimony that it was sent to all A-B distributors nationwide, as reflected on the memorandum itself.

[5] Plaintiffs challenge the credibility of this testimony by DeMarco with evidence of the distribution practices of Rutgers Distributors in New York State. Rutgers is a wholly-owned

He further stated that his understanding of the 1974 A-B Equity Agreement was repeatedly confirmed by A-B/St. Louis.

> [T]hey have always felt and have told us many, many times in many different way[s] and fashions that, as they see it, it would be best for both the brewer, the wholesaler and the entire wholesaler family to maintain their responsibilities and do the job necessary in their particular market.

In particular, DeMarco referred to meetings convened by A-B/St. Louis at various times prior to December 1982 at which management representatives of A-B/St. Louis reiterated the company's policy regarding extra-territorial sales.

> In those meetings it was indicated quite often by the top brass to stay within your [area of] primary responsibility and assume your

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subsidiary of High Grade. Although Rutgers and High Grade had identical agreements with A-B/St. Louis during the period of 1974 to 1982, Rutgers consistently sold A-B products to Class C licensees in New York outside of its assigned APR. Plaintiffs argue that Rutgers' willingness to engage in extra-territorial sales effectively undermines DeMarco's professed interpretation of the 1974 A-B Equity Agreements as prohibiting such sales.

The A-B defendants contend that the beer distribution system in New York is dramatically different from that in New Jersey and most other states. According to the A-B defendants, Class C licensees in New York act as independent or "gypsy" beer distributors. They have no contract with A-B/St. Louis and purchase beer in large quantities from regular distributors at reduced prices for resale to retailers or consumers wherever they please. The A-B defendants assert that such distributors comprise a fourth tier in the beer distribution chain in New York for which there is no analogue in New Jersey.

Rutgers' sales of A-B brands to Class C licensees in New York appear to have no relevance to the subject of this lawsuit. This case pertains to the origin of territorial restraints on the wholesale distribution of A-B products to retail accounts. There is no evidence that Rutgers ever sold A-B beer to retail accounts located outside its assigned APR. Thus, in this critical respect, there is no evidence that Rutgers' conduct was inconsistent with that of High Grade.

> responsibilities in that area and do the type of job necessary through your marketing sales efforts.

There is evidence that sales personnel at A-B/Newark were instructed in even more direct terms to confine sales to the marketing area assigned by the brewer. Raymond Arps testified that when he was first employed by A-B/St. Louis as sales manager at A-B/Newark in March 1982, he was told by his immediate supervisor that A-B/Newark was prohibited by A-B/St. Louis from selling A-B products outside its marketing area.

In contrast to the considerable evidence showing the existence of an A-B/St. Louis policy against extra-territorial sales and the A-B defendants' awareness of this policy, plaintiffs' evidence offered in support of their contention that A-B/St. Louis "did not care whether [its] distributors were selling outside their [APRs]" is extremely thin. For example, plaintiffs note that representatives of Ritchie & Page, Crown and Konrad each testified that they were not told by A-B/St. Louis prior to December 1982 that they were not permitted to sell outside their territories, or that A-B/St. Louis did not want them to do so. In particular, plaintiffs highlight the following testimony of Ralph Rapisardi of Crown:

> Q: During that time period, 1979 to 1982, did anyone from Anheuser-Busch tell you or suggest to you that you were not permitted to sell outside your Anheuser-Busch APR?

A: No.

* * *

Q: Okay. During that time period, 1979 to the end of 1982, did anyone from Anheuser-Busch tell you that Anheuser-Busch didn't want you to sell beer outside of your Anheuser-Busch area of primary responsibility?

A: No.

* * *

Q: During the time period 1979 to 1982 did anyone from Anheuser-Busch tell you that it would be a good idea for you not to sell beer to retailers outside your Anheuser-Busch APR?

A: No.

However, as previously noted, Rapisardi was employed by A-B/St. Louis between 1948 and 1969 in various sales, supervisory and managerial positions. He has stated and plaintiffs do not dispute that during this extensive period of employment he became intimately familiar with the brewer's policy regarding out-of-territory sales by distributors of its beer. Furthermore, there is no evidence that Crown ever sold A-B products outside its assigned territory. There was therefor no apparent reason for A-B/St. Louis to expressly remind Rapisardi during the period of 1979 through 1982 of the company's policy. Similarly, Thomas Ryan of Ritchie & Page was employed by A-B/St. Louis for 15 years during which time he served as a Division Manager, National Sales Manager, and Assistant to the Vice-President for Marketing. There was certainly no need for A-B/St. Louis to instruct Ryan on the company's marketing strategy and distribution policies once he became Chief Executive Officer of Ritchie & Page. Indeed, Ryan testified that as a Division Manager for A-B/St. Louis he was responsible for conveying these policies to other independent wholesalers. Konrad testified that he derived his understanding of the brewer's policy from the language of the 1974 A-B Equity Agreement. In his words, "I believe ... that the spirit of the agreement stressed that they wanted us to sell in our market area." I have already noted that this interpretation of the agreement is entirely reasonable. In addition, while Konrad was not told in so many words that A-B/St. Louis did not want him to sell outside Konrad's APR, he was advised during a meeting with representatives of A-B/St. Louis that they did not want him to engage in sales activity which might dilute Konrad's efforts to maximize sales of A-B products within his market area.

In further support of their contention that A-B/St. Louis adopted a post-Schwinn laissez faire attitude toward extra-territorial sales by the A-B defendants, plaintiffs point to the April 30, 1975 letter from A-B/St. Louis to Konrad and Ritchie & Page (discussed supra). However, the entire contents of this letter actually cut against the plaintiffs' position. While perfunctorily stating that A-B/St. Louis has no right under the law to resolve the distributors' "area dispute", the body of the letter leaves no doubt as to the brewer's position. The clear message conveyed by the letter is that A-B/St. Louis was satisfied with the status quo and under no circumstances should the distributors actively compete between themselves for the retail accounts in question. Significantly, the tone and overall effect of this letter is very similar to that of the 1974 A-B Equity Agreements. Rather than demonstrating the absence of an A-B/St. Louis policy against extra-territorial sales, as plaintiffs contend, the letter appears to represent yet another example of the manner by which A-B/St. Louis endeavored during the Schwinn era to communicate its preference for territorial exclusivity while avoiding the appearance of imposing such exclusivity on its distributors.

With regard to the rationality of the A-B defendants' purported fear of brewer sanctions, there is no question that the risks to personnel of A-B/Newark associated with engaging in extra-territorial sales were real and substantial. A-B/Newark personnel were employees of A-B/St. Louis. As in any employment relationship, the ultimate sanction for deviating from the express policy directives of the company was employment termination. William Reisenbeck, who as the former Eastern Region Manager of the A-B Wholesale Operations Division was responsible for the operation of A-B/Newark, testified:

> Q: What was your understanding as to what would happen if there was a management at the Newark operation that sought to increase sales be [sic] beyond their territory?
>
> A: They would probably get fired.
>
> Q: Why do you say they would get fired if they went beyond their territory of area?
>
> A: It's just a very strong policy of the company, you do not sell outside the territory, period.

Whether the fear of brewer sanctions asserted by the remaining five independent A-B wholesaler defendants constitutes a credible non-conspiratorial business justification for refraining from extra-territorial sales presents a more difficult question. Not surprisingly, there is no evidence that these A-B defendants were ever overtly threatened by A-B/St. Louis with termination of their distributorship agreement or other sanctions if they engaged in sales outside their assigned APRs. At least during the period when the Schwinn per se rule was in effect, A-B/St. Louis could not have terminated or expressly threatened to terminate an independent distributor solely for its refusal to restrict sales to the brewer-assigned APR without exposing itself to antitrust liability. Even under the most narrow interpretation of Schwinn, any such terminations or threats of termination would likely have been construed to be the kind of "firm and resolute" enforcement of vertical restraints on product resale expressly prohibited by the Schwinn Court. 388 U.S. at 372; see also, Janel Sales Corp. 425 F.2d at 406.

The evidence suggests that some if not all of the A-B defendants were aware of the legal constraints on the brewer's ability to strictly enforce its policy favoring territorial exclusivity. For example, in the April 30, 1975 letter from A-B/St. Louis to Konrad and Ritchie & Page, the brewer expressly stated that "the law does not allow exclusivity." Thus, for the A-B defendants' professed fear of brewer sanctions to be credible, their apprehensions must have been reasonably grounded in a belief that A-B/St. Louis might contrive alternative reasons for imposing sanctions as a pretext for punishing a distributor for engaging in extra-territorial sales. There is ample evidence in the record to support a conclusion that such apprehensions would not have been unreasonable.

Under paragraph 15 of the 1974 A-B Equity Agreement, A-B/St. Louis reserved "the right to terminate this Agreement at any time by giving Wholesaler at least 90 days written notice ... Upon such termination, the relationship between Anheuser-Busch and Wholesaler shall thereafter be that of purchaser and seller on an individual purchase order basis, ... terminable at will by either party at any time." The agreement also required the distributor to satisfy Sales and Merchandizing Standards which were worded in general and indefinite terms. Under paragraph 5 of the agreement, failure to satisfy these standards in its APR was grounds for termination of a distributor's relationship with A-B/St. Louis.

> If a Wholesaler should fail to use or observe one or more of the sales and merchandizing methods and standards ... in a manner and to the extent consistent with the type of market which is Wholesaler's primary market area, Anheuser-Busch shall have the right to terminate this Agreement.

The first two paragraphs of the 1974 A-B Equity Agreement also define the distributor's obligations in extremely broad terms. Under paragraph one, the distributor agreed "to exercise its best efforts" to market A-B products in its designated APR. Paragraph two further refers to the distributor's "efforts to achieve maximum market representation" of A-B products in the assigned territory. Plaintiffs' own experts acknowledged during their oral depositions that A-B/St. Louis was the final arbiter of whether each A-B defendant was exerting its "best efforts" to achieve "maximum market representation" and satisfying the brewer's sales and merchandizing standards within its APR as required under the agreement. Dr. Jordan admitted that the criteria for determining whether a distributor had expended its "best efforts" in its APR were not set forth in the agreement. Dr. Stiglitz similarly testified that the "best efforts" requirement was "made perhaps a deliberately vague term." Dr. Jordan further stated:

> Q: Where I direct your attention to are these words, "wholesaler's efforts to achieve maximum market representation of Anheuser-Busch products in wholesaler's primary market area ...
>
> What does that mean to you?
>
> A: It means representing Anheuser-Busch in the market in a manner that in the opinion of Anheuser-Busch is acceptable.

The broad and undefined nature of the distributor's obligations under the agreement unquestionably conferred upon A-B/St. Louis considerable latitude to find fault with the distributor's performance and come up with sufficient grounds for termination if in the brewer's own judgment it felt the distributor's conduct warranted such action.

The 1974 A-B Equity Agreement also did not preclude A-B/St. Louis from unilaterally imposing other sanctions on a distributor short of termination for failure to satisfy the brewer's expectations. Paragraph one of the agreement stated that A-B/St. Louis "does not grant exclusivity to Wholesaler in its primary market area." Under a reasonable interpretaion of this provision, A-B/St. Louis could, without giving a reason or justifying its action, appoint a second wholesaler to market A-B products in an existing wholesaler's APR. When confronted with this prospect during his deposition, Dr. Jordan conceded that such an action by A-B/St. Louis would be a serious sanction to a distributor which could be tantamount to an "effective termination." In response to violations of its marketing policies, A-B/St. Louis also could withhold at its discretion certain assistance upon which the A-B defendants relied, including credit for beer purchases, marketing and advertising materials, and funds aimed at sharing the cost of the distributor's promotional activities.

Thomas Ryan, who as previously mentioned became Chief Executive Officer of Ritchie & Page after having been employed by A-B/St. Louis in key managerial positions for 15 years, stated in his certification that "wholesalers, including Ritchie & Page, would invite potentially hostile brewer scrutiny if it sold outside its designated territory and challenged Anheuser-Busch's policy." As reflected in the preceding discussion, A-B/St. Louis had ample opportunity to penalize a distributor for engaging in extra-territorial sales without having to disclose the underlying reason for the punitive actions.

The record further demonstrates that the business circumstances of the A-B defendants were such that they could ill afford to engage in conduct which might provoke a punitive response from A-B/St. Louis. The sale of A-B products represents the vast majority of each of the A-B defendants total sales. In particular, the sale of A-B products comprises 80% of High Grade's current total sales, approximately 95% of Harrison's total sales since at least 1979, at least 90% of Ritchie & Page's total sales from 1978 to the present, 97% or more of Konrad's current total sales, and 98.6% of Crown's current total sales and over 90% of its total sales since 1979. Given the degree of their dependence on the sale of A-B products, the A-B defendants could have reasonably concluded that the prospect, however remote, of being penalized by A-B/St. Louis for violating its marketing policies was an unacceptable business risk. Indeed, Dr. Jordan conceded during his deposition that a distributor's decision to refrain from distributing beer outside its assigned territory would be a rational business decision even if the risk of termination for this conduct was relatively slight. He testified that if a distributor had a 99% chance of making $1,000 per month profit on out-of-territory sales but was subject to a

1% chance of termination of the distributorship as a result of these sales, it would be a reasonable business decision for a distributor to decide not to take that risk.

Plaintiffs argue that the A-B defendants' purported fear of brewer sanctions is belied by the absence of any record evidence that A-B/St. Louis ever actually penalized a distributor for selling outside its assigned territory. This argument, however, places the proverbial cart before the horse insofar as there is also no evidence that the A-B defendants ever gave A-B/St. Louis a reason to impose such penalties. Plaintiffs themselves concede that, with the exception of a few isolated instances, the A-B defendants confined their sales activity to their respective APRs.

Moreover, the record does show that A-B/St. Louis did terminate its relationship with three separate New Jersey distributors in the 1950's for inadequate sales and merchandizing performance in their assigned territories. While there is no evidence that these distributors were terminated for engaging in extra-territorial sales, the terminations do reflect the willingness of A-B/St. Louis to impose the severest of sanctions for a distributor's failure to meet the brewer's vaguely-defined standards of performance. This lesson certainly was not lost on Harrison which acquired the territories of two of the terminated distributors, or High Grade which was given part of the territory of the third.

Plaintiffs further argue that the A-B defendants could not have reasonably feared punishment by the brewer for sales outside their APRs because A-B/St. Louis never implemented a formal procedure for detecting such sales behavior. Plaintiffs rely on testimony of Richard Woodruff that he never asked any of the A-B defendants whether they were selling outside their APRs or whether other A-B distributors were selling in their APRs, and that he was not aware of any other employee of A-B/St. Louis assigned the responsibility of ascertaining whether any of the A-B defendants were selling A-B products outside of their APRs. However, A-B/St. Louis was undoubtedly aware of the amount of beer it was delivering to each distributor, and, in accordance with the Sales and Merchandizing Standards set forth in the 1974 A-B Equity Agreement, each distributor was required to maintain records "to reflect sales made to individual retail establishments served by Wholesaler" and to promptly submit to A-B/St. Louis "Sales and Inventory reports and such other records and reports and financial data as from time to time may reasonably be requested by Anheuser-Busch." On the basis of these facts alone, the A-B defendants could have reasonably concluded that sales of A-B products outside their respective APRs would not go undetected by A-B/St. Louis for long.

The evidence demonstrates that A-B/St. Louis long maintained a strong policy preference for territorial exclusivity, and that the A-B defendants were fully cognizant of this policy preference. There is also a sufficient factual basis for concluding that the A-B defendants reasonably believed that they would have jeopardized their relationship with A-B/St. Louis and risked losing a major share of their business if they failed to comply with the brewer's policy. One of plaintiffs' own economic experts admitted that this risk justified a decision to refrain from extra-territorial sales. In effect, the A-B defendants have adduced a sound business reason for refraining from intrabrand competition. Thus, plaintiffs' evidence that the A-B defendants failed to take advantage of profitable sales opportunities outside their assigned territories does not "tend to exclude the possibility" that this conduct was entirely consistent with their long-term economic interests.

d. Motive

Under _Venzie_, no conspiracy may be inferred from circumstantial evidence unless the defendants shared a common motive to coordinate their behavior. 521 F.2d at 1314. Although questions of motivation implicate the actual state of mind of the actors whose conduct is being challenged, in practice the state of mind of antitrust defendants must be inferred from objective business conditions. If under the factual circumstances which gave rise to the challenged conduct the defendants could not have reasonably believed that they would realize a distinct benefit from concerted action, they would have had no incentive to coordinate their behavior and there would be no basis for inferring a conspiracy. In other words, a common motive to conspire will not be inferred from circumstantial evidence unless this evidence supports a conclusion that reasonable persons in the defendants' position had something to gain from coordinated behavior. See, Areeda, supra. at ¶ 1412. Similarly, a common motive to conspire will not be inferred from circumstantial evidence unless this evidence tends to show that the defendants would not have enjoyed certain economic benefits in the absence of concerted action. A conspiracy would be economically senseless if the alleged conspirators would have derived the same business advantages whether or not they coordinated their conduct.

I concluded in the preceding section that the refusal of the A-B defendants to engage in intrabrand competition was consistent with their long-term economic interests. In particular, they avoided the risk of provoking brewer sanctions which could have destroyed their businesses. The evidence additionally suggests that the A-B defendants derived other substantial economic benefits by complying with the brewer's policy favoring territorial exclusivity. The evidence demonstrates that this policy was a central feature in a successful nationwide marketing strategy. There is no dispute that A-B/St.Louis and its New Jersey distributors gained dramatic increases in market share over the past twenty years. For example, Ralph Rapisardi noted in his affidavit that Crown held a market share of only 8 or 9 percent in 1969, but currently holds a market share in excess of 50 percent. Mr. Rapisardi and other of the A-B defendants expressly attributed these marketing advances to their willingness to focus their efforts on servicing retail accounts within their assigned territories in full compliance with A-B/St. Louis corporate policy. While there is no way of determining from the record the extent to which the absence of intrabrand competiton was responsible for these increases in market share, the A-B defendants could have reasonably concluded that strict adherence to the brewer's policy was an important contributing factor. See generally, Sylvania, 433 U.S. at 54-55 (noting the potential procompetitive effects of vertical territorial restraints). Rather than grudgingly complying with the brewer's policy favoring territorial exclusivity solely as a means of preserving their A-B distributorships, the evidence shows that the A-B defendants approved of the policy, financially benefitted from it and willingly followed it. Thus, for there to be a genuine issue of material fact on the question of motive, plaintiffs must present some evidence from which it can reasonably be inferred that a horizontal conspiracy would have conferred certain benefits upon the A-B defendants separate and apart from any benefits they derived from merely complying with the vertical direction of the brewer.

Plaintiffs contend that the refusal of the A-B defendants to engage in intrabrand competition gave them a monopoly over the sale of A-B products in their respective territories. Plaintiffs argue that this monopoly enabled the A-B defendants to artificially inflate their prices above those levels which otherwise would have existed if they had actively competed among themselves for sales to retail accounts outside their assigned territories. Plaintiffs conclude that the A-B defendants' interest in maintaining monopoly control over the pricing of A-B products provided them with a powerful economic incentive to horizontally conspire to allocate and enforce exclusive territories. However, plaintiffs' own economic experts testified that these anticompetitive effects on pricing would be present regardless of whether territorial exclusivity were maintained at the vertical direction of A-B/St. Louis or through a horizontal conspiracy. Thus, if the A-B defendants were able to obtain monopoly control over pricing merely by adhering to brewer-directed restraints on intrabrand competition, they would have no additional reason to conspire horizontally to achieve the same result. In other words, the motive to enter a horizontal conspiracy was at best no greater than the motive to continue adhering to the policy of A-B/St. Louis. Under Matsushita, such ambiguous circumstantial evidence does not create a "genuine issue for trial." 106 S. Ct. at 1362 n.21. Even if plaintiffs were able to prove at trial that restraints on intrabrand competition enabled the A-B defendants to increase prices beyond competitive levels, this fact alone would not permit a jury to choose between the competing inferences of conspiratorial or non-conspiratorial motive.

Given their admitted satisfaction with the brewer's policy favoring territorial exclusivity, the A-B defendants might have had a plausible reason to reinforce the vertical direction of A-B/St. Louis with a horizontal agreement to the same effect, particularly in the post-Schwinn era when A-B/St. Louis was legally disabled from directly enforcing the exclusivity of its assigned APRs. However, there is not the slightest hint in the evidence that any such reinforcement was ever needed. The need for strengthening existing vertical restraints on intrabrand competition with a horizontal agreement would not have arisen unless one or more of the A-B defendants exhibited a willingness or desire to encroach upon neighboring territories in violation of the brewer's policy and the brewer failed to exert its power and influence to prevent or attempt to stop such activity. There is no evidence that any of the A-B defendants showed the slightest inclination following the Schwinn decision to expand their sales activity beyond their assigned territories. Rather, the evidence shows only that the A-B defendants honored the boundaries of their assigned territories before, during and after the period when Schwinn was in effect. Furthermore, as the evidence relating to the "area dispute" between Konrad and Ritchie & Page illustrates, when questions arose during the Schwinn period regarding the allocation of retail accounts located along the boundaries of the brewer-assigned territories, the A-B defendants sought the direction of A-B/St. Louis rather than resolving the questions themselves as would be expected if there were a horizontal agreement.

The evidence demonstrates that the interest of each of the A-B defendants in complying with the policy of A-B/St. Louis favoring territorial exclusivity was sufficiently compelling to obviate any need or motivation to conspire horizontally. Plaintiffs, on the other hand, have failed to show that the A-B defendants would have derived any separate benefits from entering a horizontal conspiracy.

e. Conclusion

The evidence in this case supports a conclusion that the A-B defendants had an independent (i.e., non-conspiratorial) business reason for refraining from intrabrand competition. In particular, there is a sufficient factual basis for finding that the policy preference of A-B/St. Louis for territorial exclusivity was a significant factor impinging upon the business decisions of the A-B defendants and that the A-B defendants purported fear of brewer sanctions for engaging in extra-territorial sales was reasonable under the circumstances. Plaintiffs for their part have failed to present evidence which tends to exclude the possibility that the A-B defendants were merely responding to the vertical direction of A-B/St. Louis when they confined sales to their assigned APRs. Rather, the evidence offered by plaintiffs as proof of a horizontal conspiracy is in virtually every instance equally consistent with conduct resulting from vertically-directed restraints on intrabrand competition.

The reports and deposition testimony of plaintiffs' economic experts do not cure these evidentiary deficiencies. Dr. Jordan's report, for example, points out a number of factors showing that the A-B defendants could have profitably sold A-B products outside their assigned APRs. He repeatedly concludes that the A-B defendants' failure to make such sales can be explained "only" by a horizontal conspiracy. However, he admitted during his deposition that this conduct was equally explainable by compliance with vertical direction from A-B/St. Louis.

Dr. Stiglitz devoted much of his report to identifying certain anticompetitive effects resulting from the defendants' practice of confining sales to their assigned APRs. Dr. Stiglitz also acknowledged in deposition testimony that a number of these anticompetitive effects were consistent with exclusive territories resulting from either a horizontal conspiracy or vertical direction. In fact, he identified only two such effects which he considered consistent with horizontal conspiracy but inconsistent with vertical direction: 1) the static, inefficient design of the defendants' territories, and 2) the practice of some defendants not to deliver beer to a co-op located inside their territories if the beer was ordered by members of the co-op located outside their territories. Dr. Stiglitz concluded that these two factors were inconsistent with vertical direction by A-B/St. Louis because they resulted in inefficient delivery to retailers and A-B/St. Louis had an incentive to see that its products reached retailers as efficiently as possible.

With regard to the first of the above factors, Dr. Stiglitz noted that if A-B/St. Louis had been responsible for the system of territories he would have expected to see periodic realignments of the boundaries to minimize delivery costs in light of changing demography and roads. However, this observation ignores interests other than minimizing distributor transportation costs which might have been equally if not more important to A-B/St. Louis. A-B/St. Louis had an expressed interest in encouraging its distributors to invest the time, energy and resources necessary to develop and maintain the good will of beer retailers in the distributors' assigned territories. The 1974 A-B Equity Agreement reflects the brewer's belief that successful beer wholesaling "requires highly personalized promotion and sales service efforts." The agreement further requires the distributor's best efforts in "maintaining satisfactory and continuous liaison with the retail trade." The Supreme Court in Sylvania expressed this interest in the following terms:

> Established manufacturers can use [vertical restrictions] to induce retailers to engage in promotional activities or to provide service and repair facilities necessary to the efficient marketing of their products ... The availability and quality of such services affect a manufacturer's good will and the competitiveness of his product.

433 U.S. at 55. Periodic realignment of territorial boundaries by A-B/St. Louis which resulted in distributors losing market areas in which they had invested their efforts undoubtedly would have discouraged them from continuing to make such investments.

The record reflects that the second factor cited by Dr. Stiglitz relating to co-op sales has little if any relevance to plaintiffs' conspiracy claims against the A-B defendants. Konrad, Ritchie & Page and Crown never refused a co-op order because they never received a co-op order during the relevant time period. A-B/Newark and Harrison refused to sell to any co-ops, not just to co-op members outside their territories.

The deficiencies in plaintiffs' evidence of a horizontal conspiracy among the A-B defendants is particularly pronounced when the evidence as to the participation of each individual A-B defendant in the alleged conspiracy is separately analyzed. The evidence of A-B/Newark's involvement in the alleged conspiracy is weak to non-existent. In particular, plaintiffs cite to A-B/Newark's acquiescence in High Grade's sales to Witty's Rahway and the fact that A-B/Newark received a telephone call from another distributor regarding the transshipping of International Beverage Company. I have already discounted this evidence as not probative of a horizontal conspiracy. Lastly, in what can only be attributed to a desperate effort to implicate A-B/Newark in the alleged conspiracy, plaintiffs rely on testimony of Dr. Stiglitz to the effect that "A-B/Newark may have served as a cartel ringmaster enforcing the horizontal conspiracy through the agency of the brewer." Neither Dr. Stiglitz nor the plaintiffs offer a single shred of evidence to support this rank speculation.

With regard to the other independent A-B wholesaler defendants, evidence of practices such as the exchange of beer at cost, selective sales abstention, and convenience sales, as noted earlier in this opinion, is entirely consistent with vertically-directed territorial exclusivity. The balance of the evidence, most of which also has been addressed at one point or another in this opinion, is not sufficiently probative of each individual distributor's involvement in the alleged horizontal conspiracy to generate a material issue for trial.

Summary judgment on the issue of conspiracy is granted in favor of each of the A-B defendants.

2. Circumstantial Evidence of a Miller Distributor Conspiracy.[6]

a. Parallel Conduct

Unlike the A-B defendants, the Miller defendants do not concede that they engaged in parallel business behavior. In particular, the Miller defendants assert that there was no common pattern to their sales behavior. The majority of the Miller defendants made sales of Miller products outside the territories assigned to them by Miller. Warren's sales of Miller products outside its assigned territory were always in excess of 5% of its total sales between 1979 and 1983. For example, 6.43% of its total sales in 1982 were comprised of sales to retailers located outside its assigned territory. In 1983, prior to entering the exclusive territorial agreement with Miller, Warren's sales outside its APR constituted approximately 14% of its total sales. Hub City sold Miller products to between 5 and 10 retail accounts in Warren's assigned territory between 1979 and 1983. MS&W similarly sold Miller products on a regular basis to six on-premises retail accounts in Warren's APR and also sold some Miller products in Kristen's APR. Point Pleasant made as much as 1.4% of its total annual sales between 1979 and 1982 to retail accounts outside its assigned territory. Kristen made a small fraction of its total sales between 1981 and 1983 to co-op members located outside its territory. Trip sold Miller products to a single retail account in Kristen's territory for a brief period in 1981 or 1982. Garden State, Hub Beer and South Jersey sold no Miller beer out of their Miller assigned territories.

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[6] The independently admissible evidence on which plaintiffs rely to establish the existence of a conspiracy among the Miller defendants and the participation of each of the Miller defendants in the alleged conspiracy was proffered by them on the hearing on these motions.

The Miller defendants contend that the undisputed evidence that most of them sold varying quantities of Miller beer outside their assigned territories destroys plaintiffs' theory of concerted action by the Miller defendants to maintain exclusive territories. This contention certainly would be correct if the scope of the horizontal conspiracy alleged by plaintiffs is limited to an agreement to confine sales to the boundaries of the territories assigned to each distributor by Miller. The report of Dr. Jordan reflects that this was his understanding of the nature of the plaintiffs' conspiracy claims. The issues addressed in his report are twofold: 1) prior to May 1983, "did the defendant distributors treat their [brewer-assigned] APRs as if they were exclusive distribution territories," and "[i]f so, 2) were these exclusive territories the result of a horizontal conspiracy among the defendant distributors?" However, plaintiffs' conspiracy claims cannot be read quite so narrowly. The gravamen of plaintiffs' complaint is that the defendants conspired to eliminate intrabrand competition by maintaining a system of exclusive distribution territories in which each distributor agreed to confine its sales. Plaintiffs allege in paragraph 33 of their complaint:

> The purpose and effect of said system is that no distributor sells beer outside of that distributor's exclusive territory; no member of the plaintiff class can buy any brand of beer from a distributor other than the exclusive distributor for that brand of beer in the area in which the class member is located.

Plaintiffs contend that the parameters of the exclusive territories were established by agreement among the distributors, and that these territories were not necessarily coincident with the Miller-assigned territories.

Two equally plausible inferences may be drawn from the undisputed evidence that the Miller defendants engaged in sales outside their Miller-assigned territories. It could reasonably be inferred from this evidence that the Miller defendants in fact actively engaged in intrabrand competition during the relevant time period in contradiction of plaintiffs' conspiracy claims. On the other hand, this evidence might simply reflect the fact that the Miller defendants established exclusive territories which were not coextensive with the Miller-assigned APRs. Thus, evidence of sales outside the brewer-assigned territories, standing alone, has an essentially neutral impact on plaintiffs' conspiracy claims.

The critical issue is whether the Miller defendants who sold Miller products to retailers outside their Miller-assigned territories were actively competing for these sales with the Miller distributors in whose brewer-assigned territories these retailers were located. The importance of this question should not be underestimated. As will be developed below, plaintiffs' allegation that the Miller defendants conspired to eliminate intrabrand competition necessarily could not survive in the face of uncontroverted evidence that they actively engaged in intrabrand competition during the relevant time period. On the other hand, if the evidence shows that the Miller defendants in whose brewer-assigned territories other Miller distributors were selling Miller products did not object to these sales, or did not attempt to recapture these sales, or otherwise appear to have acquiesced in these sales, this evidence would significantly strengthen the inference that the Miller defendants had allocated retail accounts among themselves and adjusted the boundaries of the brewer-assigned territories by horizontal agreement.[7] The evidence clearly favors the inference that the extra-territorial sales of the Miller defendants were the product of intrabrand competition and not simply a manifestation of a horizontal conspiracy.

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[7] The inference of conspiracy would be all the more compelling

There is some evidence that the Miller defendants did not acquiesce in incursions into their Miller-assigned APRs by other of the Miller defendants. In answers to interrogatories, Kristen stated that there were occasions when other Miller distributors, believed to be Trip and Warren, made sales of Miller products to retailers located in Kristen's APR. Kristen voiced its objections to these sales "[d]uring a few and isolated conversations between Kristen and Trip ... and Warren .., respectively, concerning other subject matters." There would have been no reason to raise such objections if these sales by Warren and Trip were made pursuant to a horizontal realignment of the brewer-assigned territories.[8] In further response to these

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in view of the fact that the very existence of sales outside the Miller-assigned territories detracts from the credibility of the Miller defendants' purported fear of provoking brewer sanctions by engaging in such sales.

[8] Plaintiffs argue, apparently in the alternative, that these direct communications are evidence of the existence of a horizontal agreement between the Miller defendants not to sell in each other's territories. However, objections of this sort would be expected whether the distribution territories were established by horizontal agreement or vertical direction from Miller. If the latter were the case, the distributor also would be expected to complain to Miller about the extra-territorial sales by the other distributors. In its interrogatory answers, Kristen stated that it notified Miller that other of the Miller defendants were distributing Miller products in its APR so that Miller would not hold Kristen responsible if any of these products did not meet Miller's quality standards.

incursions by Trip and Warren into its APR, Kristen "sought to obtain the retail accounts involved through [Kristen's] sales representatives visiting the accounts and emphasizing [Kristen's] service and reliability." David Kramer of South Jersey Distributors, Inc., the predecessor of defendant South Jersey, similarly testified that there was a single retailer in its APR, the Village Pub in Beach Haven, which refused to purchase Miller products from South Jersey Distributors, Inc. due to a personal disagreement with the previous owners of the distributorship. Instead, the Village Pub purchased its inventory of Miller

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Furthermore, the nature and substance of Kristen's communications with Trip do not support the inference of conspiracy. Plaintiffs contend that Agnes Kristen, Vice-President of Kristen, telephoned Francis Tripucka, President of Trip, and "requested him not to sell Miller beer to retailers located in her territory." However, in her deposition testimony and in an affidavit submitted in response to plaintiffs' opposition to the present summary judgment motion, Agnes Kristen stated that the purpose of her phone call to Mr. Tripucka was to advise him that a single retailer in Kristen's APR, Chas Vic, was in default on its credit obligations and that she believed that credit sales to Chas Vic by Trip would be in violation of the New Jersey ABC regulations. Under N.J.A.C. 13:2-24.4, in the event a retailer defaults on its credit obligations to a wholesale distributor, the distributor is required to notify all other distributors of the default, and credit sales to the defaulting retailer are prohibited until the default is cured. N.J.A.C. 13:24.4(c)(2). So long as the retailer remains in default, sales can only be made on a C.O.D. basis. When Kristen put Chas Vic on C.O.D., Chas Vic's owner told Kristen's salesman that Chas Vic was still able to obtain credit from Trip. Kristen testified that she called Tripucka to inform him of the fact that Chas Vic was in default.

There is no evidence that Kristen ever requested that Trip refrain from selling Miller products to Chas Vic or any other retailer in Kristen's territory. At best, the evidence of this telephone communication demonstrates only an opportunity to enter into an unlawful agreement. As previously noted, such evidence is insufficient to defeat summary judgment. Venzie, 521 F.2d at 1313.

products from Point Pleasant. Notwithstanding the fact that Point Pleasant was already servicing the Village Pub, apparently with the authorization of Miller, South Jersey Distributors, Inc. endeavored to convince the retailer to change distributors. However, "no amount of persuasion by [its] salespeople [could] convince [the Village Pub] to buy from [South Jersey Distributors, Inc.][9] Edward Goracy also testified that if Warren became aware that other Miller distributors were making co-op sales of Miller products to co-op members located in Warren's APR, it would respond by analyzing its prices to determine whether they were at competitive levels. "[Warren] had to compete and take a look at [its] prices so that [it] could meet that competition and serve those customers." The conduct of Kristen, South Jersey Distributors, Inc. and Warren described above is indicative of some degree of intrabrand competition among the Miller defendants.

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[9] There is additional evidence that Point Pleasant's sales to this single retailer did not result from an agreement between South Jersey Distributors, Inc. and Point Pleasant to allocate this retail account to Point Pleasant. John Wardell of Point Pleasant testified that the "Miller Brewery wants full distribution and they want to be selling every account, every retail license, in the market ... [P]rior to '81 ... [the Village Pub] would not buy from ... [South Jersey Distributors, Inc.], and, as I remember, Miller wanted them serviced and wanted the distribution and they said to go ahead and serve them." This testimony shows that Point Pleasant's sales to the Village Pub were made at the direction and with the permission of Miller.

Moreover, Beach Haven is located at the southernmost end of Long Beach Island. Point Pleasant's Miller territory did not include Long Beach Island although it sold other brands of beer there. As the plaintiffs themselves note in their opposition brief, "[i]n order to reach Beach Haven, Point Pleasant trucks had to take a narrow causeway out to Long Beach Island, and had to pass through the Town of Ship Bottom, where Point Pleasant had retail accounts to whom they regularly sold other brands of beer, but not Miller." I can conceive of no business reason for Point Pleasant and South Jersey Distributors, Inc. to have divided retail accounts for the distribution of Miller products on Long Beach Island in such a seemingly haphazard and economically senseless manner. The only rational inference which can be drawn from the evidence of Point Pleasant's sales to the Village Pub is that Point Pleasant was simply responding to the vertical direction of Miller.

Apart from its sales to the Village Pub, Wardell testified that Point Pleasant had also sold Miller products to one retailer in Ship Bottom and possibly two or three other retailers on Long Beach Island. However, there is no evidence regarding the factual circumstances surrounding these sales.

Whether exclusive territories are established by horizontal agreement or vertical direction, one would expect there to be contiguous and identifiable boundaries to the territories and that each distributor would attempt to achieve maximum coverage in its defined market area on an ongoing year-round basis. The evidence shows that the Miller defendants persistently sought to establish regular accounts with each retailer located within the boundaries of their Miller-assigned APRs. For example, Frank Tripucka testified that Trip was "constantly striving" to expand the number of retailers within its APR to which it sold Miller products.

> Q: Does the Miller Brewing Company require you to try and sell beer ... to every account?
>
> A: Absolutely.
>
> Q: Is there a written requirement?
>
> A: No, but they constantly monitor our selling performance.

The evidence further shows that the Miller defendants instituted certain merchandizing practices which were intended to assure continuous sales of Miller products to retailers located within their Miller-assigned territories. Edward Goracy of Warren testified that Warren's merchandizing efforts within its Miller APR included a wide array of services to retailers such as weekly solicitations, weekly deliveries, and 24-hour deliveries. Goracy further testified that Warren has consistently provided all of these services "to all of Warren's retail accounts within Warren's Miller geographic distribution territory" from 1979 through to the present.

In contrast to the continuity which characterized the Miller defendants' sales efforts within their brewer-assigned territories, there does not appear to have been any consistent pattern to their extra-territorial sales as would be expected if there had been a horizontal reapportionment of the brewer-assigned territories. Kristen limited its extra-territorial sales to co-ops which had members located outside Kristen's Miller APR. MS&W sold Miller products outside its Miller APR only to a number of individual on-premises retail accounts. Whereas, Hub City confined its extra-territorial sales to retail licensees to whom it was already selling other brands of beer. Warren sold Miller products to co-op members and numerous other individual retailers outside its Miller territory.

Of the Miller defendants, Warren's extra-territorial sales activity was by far the most extensive. Significantly, there does not appear to have been any territorial direction to Warren's sales outside its Miller APR. In particular, Warren's extra-territorial sales were not concentrated in one specific area adjoining its Miller APR as might be expected if the Miller defendants had agreed among themselves to adjust the boundaries of the territories assigned by Miller. Rather, from the early 1970's when it first began distributing Miller products until 1983, Warren sold Miller products to retailers situated throughout the State of New Jersey. Frank Banko, President of Warren, stated in an affidavit submitted in support of the present summary judgment motion that throughout the early 1970's Warren sold Miller products wherever it sold the other brands of beer it carried at that time. He further stated that the brewers of these other brands did not assign territories and allowed Warren to sell their products statewide. Prior to May 1983, one of Warren's largest accounts was the Shop-Rite co-op. Warren sold Miller products to as many as 27 members of this co-op who were located in eight different counties outside Warren's Miller-assigned territory. Thus, as a result of its sales to this single co-op, Warren was effectively selling Miller products in the brewer-assigned territories of most if not all of the other Miller defendants. Frank Banko also referred to several other co-ops which had member licensees inside and outside Warren's Miller APR most of which purchased Miller products from

Warren prior to 1983. In 1982 alone, Warren also sold Miller products to over 100 other retailers outside its Miller APR. The absence of any apparent territorial direction to Warren's extra-territorial sales is inconsistent with plaintiffs' horizontal conspiracy hypothesis. It would have been impractical and economically irrational for the Miller defendants to allocate and attempt to enforce exclusive territories which had no clearly-defined or coherent boundaries.

If, as plaintiffs argue, the retail accounts to which Warren sold Miller products outside its APR were within the boundaries of a broader exclusive territory allocated to Warren by agreement among the Miller defendants, the evidence should show that Warren maintained consistent levels of sales to retailers located both inside and outside its APR. However, in contrast to Warren's merchandizing practices within its APR, there was a notable lack of continuity to its sales behavior outside its APR. Frank Banko stated in his affidavit that during the summer months, when consumer demand for beer is particularly high, Miller would "always cut [Warren's] orders sometimes with less than a day's notice." At such times, Warren could not be assured of having enough Miller beer to satisfy retailer demand both inside and outside its APR. Rather than cutting back on deliveries to all the retailers to whom it sold Miller products, irrespective of their location, Warren would reduce only its extra-territorial sales. As a result, "[d]uring the summer months a minimal amount of Miller products were sold outside [Warren's] APR."

Thus, retailers to whom Warren sold Miller products outside its APR were not treated as regular accounts allocated to Warren by horizontal agreement. Rather, the evidence suggests that Warren would independently decide to sell Miller products to retailers located outside its Miller-assigned APR only if it believed that these sales could be profitably made without jeopardizing its ability to meet the demand for Miller products within its APR. Indeed, in answers to interrogatories, Warren asserted that it had no formal or informal policy regarding requests from retailers outside its APR for the delivery of Miller products. Rather, each request was judged on an individual basis and the decision whether to fill each order was based on the profitability of the sale and the availability of the product. At his deposition, Edward Goracy similarly testified:

> Q: Did [Warren] have a policy against delivering Miller beer to retailers outside [its] Miller territory prior to 1983?
>
> A: No hard, fast policy.
>
> Q: Was it sort of a day by day basis, a delivery by delivery basis?
>
> A: More of an instance by instance type of appraisal and analysis, as the situation would arise.

The evidence of Warren's extra-territorial sales seriously undermines plaintiffs' allegation that the Miller defendants were engaged in parallel conduct in furtherance of a horizontal conspiracy.[10] At a minimum, this evidence supports the inference that Warren was not a participant in the alleged

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[10] Plaintiffs argue that the evidence of Warren's extra-territorial sales presented by way of the Banko affidavit should not be credited by the court on the present motion for summary judgment. Plaintiffs contend that the information presented in the affidavit is "inconsistent with" or "contrary to" Warren's prior answers to interrogatories and the sworn deposition testimony of Edward Goracy. The record does not bear out this contention. In interrogatories served in June 1985, plaintiffs requested each defendant to set forth its total annual sales of Miller beer outside its APR. Warren initially objected to this request as "burdensome, oppressive and overbroad." Following negotiations between counsel for Warren and the plaintiffs, Warren served supplemental interrogatory answers in which it stated that "Warren estimates that prior to May, 1983, more than 5% of its Miller sales may have been outside its territory" (emphasis added). During the course of their negotiations, plaintiffs' counsel apparently affirmed that this supplemental answer would be sufficiently responsive to the interrogatories at issue. During his subsequent deposition, Edward Goracy was asked whether "more than 95% of [Warren's] sales of Miller beer ... prior to 1983 was to retailers located within [its] Miller APR?" He testified that "[w]ithout the exact knowledge of [the] numbers, I would say that those figures might be close." He did not insist that "a more precise figure could not be calculated," as plaintiffs contend. Rather, Goracy testified that he could not provide a more precise figure without analyzing the customer billing invoices and/or sales reports for the years in question.

The record further reflects that the documents from which plaintiffs themselves could have derived more precise figures were readily available to them. According to Goracy, he and plaintiffs' counsel agreed during their negotiations that "if the plaintiffs needed further information regarding sales outside [Warren's] Miller APR that the documents would be made available at Warren's document production and that plaintiffs would compute these sales figures." Warren produced this documentation in July 1985, but plaintiffs apparently declined to make copies or otherwise perform a detailed examination of this material.

Plaintiffs further contend that the Miller defendants should not be permitted to rely on sales information which Warren conspiracy. Dr. Stiglitz conceded during his deposition that he would change his opinion about Warren being a co-conspirator if the evidence showed that Warren had made only 5% of its Miller sales outside its APR to co-ops and other large accounts and these sales were not the result of a horizontal realignment of Warren's APR. He testified, in relevant part:

> Q: What would convince you, what facts, if you found them, would convince you that Warren wasn't a co-conspirator?
>
> . . .
>
> A: If ... they had stolen say some very large accounts, some profitable large accounts from their adjacent territories.

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refused to compile in response to plaintiffs' interrogatories. However, these interrogatories sought only the total annual volume of sales and deliveries outside Warren's APR between 1979 and 1984. The Banko affidavit contains additional information regarding seasonal fluctuations in Warren's extra-territorial sales and descriptions of certain of its out-of-territory retail accounts which is outside the scope of plaintiffs' interrogatories. Thus, plaintiffs' objections to the Banko affidavit relate only to a single paragraph in which he sets forth percentage figures relating to the total volume of Warren's out-of-territory sales during 1982 and the first three months of 1983. Even if these precise percentage figures are disregarded, the fact remains that plaintiffs were on notice as early as the summer of 1985 that Warren had engaged in significant sales outside its APR estimated to have been in excess of 5% throughout the relevant time period. Indeed, Dr. Stiglitz acknowledged during his deposition that he was aware of Warren's claim that sales outside of its APR accounted for approximately 5% of its total sales. Plaintiffs certainly should have anticipated that evidence of these sales would have a direct bearing on their claim that the Miller defendants horizontally conspired to refrain from intrabrand competition.

In short, while Warren arguably should have supplemented its interrogatory answers with the percentage figures compiled by Warren and set forth in paragraph 2 of the Banko affidavit, its failure to do so does not significantly prejudice plaintiffs on the present summary judgment motion and does not warrant excluding this evidence from consideration.

Q: Such as sales to big co-ops ... or something like that?

A: That's right ... That would be strongly suggestive that ... [t]hey were not going along with the horizontal conspiracy.

Q: Would you then conclude that they were not a part of the generalized Miller conspiracy? Would that be your conclusion from that strong suggestion?

A: ... I think the answer probably is yes.

. . .

A: ... [I]f they were intruding in selling large co-ops outside their territories, large sales in an aggressive manner, expanding their sales, that at that time they -- I guess I would feel very hesitant to say they were part of the horizontal conspiracy.

. . .

A: I do know that they claim to have sold outside their territory.

Q: At the level of about five percent of sales.

A: Yes.

. . .

A: If they were selling say five percent outside their territory to large co-ops and ... this five percent does not represent a re-alignment of territories, this fact ... couldn't be interpreted in any way as satisfying needs of, you know, a Saturday or Sunday delivery, but represented an intrusion into other territories, that would be indicative ... of its non-participation as of that time in some aspects of that collusive arrangement.

. . .

> Q: Well, assuming that there was no such territorial direction to its sales, except to the extent it was dictated by where the co-ops were, would you then conclude that Warren was not a conspirator?
>
> A: I think I would.

The preceding discussion demonstrates that the facts are as Dr. Stiglitz assumed them to be in arriving at this conclusion. Warren's sales to retailers outside its APR were always in excess of 5% of its total sales during the relevant time period. Warren sold Miller products to large co-ops, at least one of which had members situated throughout the state. Moreover, the fact that there was no apparent territorial direction or continuity to Warren's extra-territorial sales makes it highly improbable that these sales resulted from a horizontal realignment of Warren's APR.

There is further evidence in the record, presented by another of plaintiffs' economic experts, that a conspiracy of the sort alleged by the plaintiffs could not have succeeded without the participation of each of the Miller defendants. Dr. Jordan wrote in his report:

> If a distributor had not been a party to the [horizontal] agreement, its actions would have generated economic incentives that would have resulted in the elimination of exclusive distribution territories.

In particular, Dr. Jordan noted:

> [I]f any one of the ... Miller distributors started selling a substantial amount of beer in all of the other ... Miller distributors' APRs, it would be in the best interest of all ... Miller distributors to perform similarly.

Dr. Jordan concluded that "[o]nly if all intra-brand distributors agree to treat their APRs as exclusive distribution territories will that system [of restraining intrabrand competition] work."

Warren's participation in a horizontal conspiracy to establish exclusive distribution territories would have been particularly crucial given the geographic position of its APR. The territory assigned to Warren by Miller during the relevant time period cut a broad swath across the north/central part of New Jersey, effectively separating the APRs of three Miller distributors to the north (Kristen, Trip and MS&W) from the APRs of five Miller distributors to the south (Hub City, Hub Beer, Point Pleasant, South Jersey and Garden State). Indeed, Warren was one of only two Miller distributors whose territorial boundaries during this period adjoined the territorial boundaries of four other Miller defendants. Thus, applying the reasoning of plaintiffs' own economic experts, a horizontal conspiracy to eliminate intrabrand competition could not have been sustained if, as the evidence suggests, Warren refused to recognize the exclusivity of surrounding territories.

Under Fed. R. Civ. P. 56, "the burden on the moving party may be discharged by 'showing' -- that is, pointing out to the District Court -- that there is an absence of evidence to support the nonmoving party's case." Celotex 106 S. Ct. at 2554. The Supreme Court in Celotex noted:

> [W]e find no express or implied requirement in Rule 56 that the moving party support its motion with affidavits or other similar materials negating the opponent's claim.

Id. at 2553 (original emphasis).

In support of their present summary judgment motion the Miller defendants have presented proof of the absence of parallel conduct well beyond what is necessary to satisfy the initial burden imposed on a moving party under Rule 56. They have presented the unequivocal denials by each of the Miller distributors that they had any knowledge of or complicity in a horizontal agreement to establish and maintain exclusive distribution territories. They have identified undisputed evidence that most of the Miller defendants made some sales outside their Miller-assigned APRs. In the case of Warren they have shown that these sales were frequent and substantial. They have also presented evidence that the extra-territorial sales of the Miller defendants did not result from a horizontal realignment of the Miller APRs. Lastly, they have offered evidence suggesting that on the basis of the above facts the plaintiffs' own economic experts might find that the alleged horizontal conspiracy could not have been formed or successfully implemented. This evidence is more than sufficient under Rule 56(c) to show the absence of a genuine issue of material fact as to the alleged parallel conduct of the Miller defendants. Indeed, the evidence summarized above tends to negate the inference of concerted action by the Miller defendants to eliminate intrabrand competition through the vehicle of exclusive distribution territories.

In opposition to a properly supported summary judgment motion, the nonmoving party must "go beyond the pleadings and by [their] own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial'." Celotex, 106 S. Ct. at 2553. In order to demonstrate the existence of a "genuine issue for trial" with regard to the alleged parallel business behavior of the Miller defendants, plaintiffs have the clear burden on the present summary judgment motion of presenting "specific facts" which tend to exclude the possibility that the extra-territorial sales of the Miller defendants were the product of intrabrand competition. Matsushita 106 S. Ct. at 1357. Plaintiffs have failed to meet this burden.

As a preliminary matter, plaintiffs offer only scant evidence to support their principal contention that "no member of the plaintiff class [could] buy [Miller] beer from a distributor other than the exclusive distributor [of Miller beer] in the area in which the class member [was] located." Retailers Maurice Bierman and Ken Friedman testified that New Jersey retailers as a general rule could only purchase particular brands of beer from the distributors in whose exclusive areas the retailers were located. However, they testified only to specific instances where particular A-B distributors refused to fill orders for A-B beer because the retailers were located outside the distributors' A-B territories. There is some evidence that certain of the

Miller defendants similarly refused to fill orders for Miller beer from retailers outside their APRs. In answers to plaintiffs' interrogatories, Trip stated that it would inform such retailers that Trip did not sell outside its APR. Point Pleasant similarly responded that it would provide such retailers with the name of the Miller distributor which serviced the retailer's area, or would ask a Miller representative to assist the retailer. However, this practice was not followed by all the Miller defendants. In answers to the same interrogatory questions, Warren asserted that it did not automatically reject orders for Miller products from retailers outside its APR. Rather, it reviewed the merits of each individual order and decided whether to fill the order on the basis of factors including but not limited to the mere location of the retailer.

Furthermore, there is other evidence which directly contradicts plaintiffs' contention that "there was no retailer that had a choice as to from which distributor he could buy [Miller] beer." Certain of the Miller defendants, including Point Pleasant, serviced retailers outside their APRs who had expressed an unwillingness to purchase Miller products from the Miller distributor in whose APR the retailer was located. As noted earlier in this opinion, Point Pleasant regularly serviced the Village Pub in Beach Haven because the owner refused to purchase Miller products from South Jersey Distributors, Inc. which was the designated Miller wholesaler for Long Beach Island at that time. MS&W similarly sold Miller products on a regular basis to an on-premises retail account in Warren's APR because the tavern's owner "didn't want to buy Miller products from Warren." Robert Luke testified:

> I do recall one customer specifically asked us to sell Miller products to him otherwise he wasn't going to buy Miller from anybody.

Kristen also stated in answers to plaintiffs' interrogatories that it had one account in the APR of MS&W which Kristen serviced prior to 1983 "by demand of that retailer and with permission of Miller." This evidence demonstrates that prior to 1983 retailers did in fact have some degree of latitude in selecting the Miller distributors with whom they would do business.

More importantly, in an effort to rebut the evidence of intrabrand competition among the Miller defendants, plaintiffs exclusively rely on conclusory arguments for which they provide little if any factual support. They contend that the evidence of sales by the Miller defendants to retail accounts outside their APRs "proves that [exclusive] territories were set by the defendants and not by [Miller]." At another point in their opposition papers, plaintiffs flatly assert that

> sales outside the [brewer-assigned APRs] (such as [those by] defendant Warren ...) are not evidence of conduct inconsistent with a horizontal conspiracy but instead confirm its existence, since it is that very conspiracy which allocated territories different from the [APRs].

On close inspection, however, it is apparent that these sweeping conclusions arise out of an evidentiary vacuum.

In support of their contention that the extra-territorial sales of the Miller defendants resulted from a horizontal realignment of the brewer-assigned territories, plaintiffs cite to only two items of evidence relating to conduct by New Jersey distributors of Miller products. First, plaintiffs cite to a single page of deposition testimony of Edward Goracy of Warren in which he stated that he had been informed by Warren's drivers and representatives of Miller that Hub City was selling Miller products to retailers in southern Middlesex County within Warren's APR prior to 1983. Plaintiffs do not explain how this portion of testimony supports their position, and there is no basis for concluding from this testimony that Hub City and Warren were or were not simultaneously soliciting business from these retailers. Indeed, the fact that Warren's drivers became aware of these sales by Hub City in Warren's APR would seem to suggest that Warren was also delivering beer to the same retailers in competition with Hub City.

Second, plaintiffs cite to testimony of Daniel Kramer of South Jersey Distributors, Inc. (the predecessor of defendant South Jersey) that in 1978 he requested that Miller withdraw a remote area consisting of six or eight retail licensees from its assigned APR because he "didn't feel that the difficulty in servicing that area warranted the expense of the deliveries." Despite Kramer's view that sales in this area were unprofitable, South Jersey Distributors, Inc. had continued to service half the retailers in the area. Point Pleasant had been servicing the others. Miller ultimately approved Kramer's request and reassigned the entire area to Point Pleasant. Plaintiffs paradoxically offer this evidence to support their claim that exclusive territories were established by agreement among the Miller distributors. However, rather than advancing their position, this evidence illustrates the weakness of plaintiffs' conspiracy theory. If there had been an operational horizontal conspiracy, South Jersey Distributors, Inc. could have settled the allocation of these retail accounts by agreement with Point Pleasant without notifying Miller or seeking its intervention. Indeed, such a request to the brewer is precisely the type of conduct which would be expected of a distributor desiring the realignment of a vertically-assigned territory.

The weakness of plaintiffs' argument that the extra-territorial sales of the Miller defendants reflect a horizontal realignment of the Miller APRs is highlighted as much by the evidence which plaintiffs have not presented as by the evidence which they have presented. Plaintiffs have not offered testimony or sworn statements from any of those retailers who are in the best position to either confirm or refute the existence of intrabrand competition among the Miller defendants prior to 1983; that is, those retailers to whom the Miller defendants, such as Warren, sold Miller products outside their APRs. These individual retailers presumably would be in a position to state whether or not the distributors designated by Miller to service the retailers' areas ever actively solicited the retailers' business during the time that the retailers were purchasing Miller products from an outside distributor. These retailers also would be in a position to state whether or not their Miller-designated distributors ever refused to fill orders for Miller products during the time that the retailers were being serviced by an outside distributor. Evidence of the absence of contemporaneous sales solicitations by the distributors assigned by Miller to service the areas in which these retailers were located and/or the refusal of the designated distributors to service retailers within their brewer-assigned territories certainly would be probative of a horizontal agreement among the Miller defendants to redefine or adjust the boundaries of their respective territories and reallocate retail accounts. Plaintiffs offer no such evidence.[11]

The ultimate conclusion of horizontal conspiracy does not follow a priori from the facts showing that the Miller defendants sold Miller products to retailers located outside their APRs, as plaintiffs seem to suggest. These facts, without more, prove only that certain of the Miller defendants did not strictly adhere to the purported corporate policy of Miller favoring the exclusivity of its assigned APRs. As previously noted, the inference of horizontal conspiracy is only one of two equally plausible inferences which can be drawn from these facts. Plaintiffs simply ignore the possibility that the Miller defendants such as Warren who engaged in extra-territorial sales were actually competing for these sales with the other Miller defendants in whose APRs the sales were made. In doing so, plaintiffs effectively assume the very conclusion which they have the burden of proving at trial; that is, that there was an absence of intrabrand competition among the Miller defendants.[12]

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[11] Plaintiffs cannot argue that they were somehow prevented from securing such evidence through the discovery process. Certain of the Miller defendants asserted in deposition testimony and answers to interrogatories that the identities of retailers located outside their APRs to whom they sold Miller products during the relevant time period were ascertainable from their business records, including customer billing invoices and sales reports. There is no suggestion in the record or in their opposition papers that plaintiffs were ever denied access to these records. In fact, Edward Goracy has stated in an affidavit that Warren produced such records in July 1985. However, plaintiffs apparently did not avail themselves of the opportunity to copy this documentation. Nor is there any suggestion in the record that plaintiffs were ever unable to obtain the cooperation of retailers.

In lieu of making any serious attempt to reconcile the extra-territorial sales of the Miller defendants with their theory of conscious parallelism, plaintiffs alternatively suggest that these sales constituted such a small percentage of the total sales of Miller beer by the Miller defendants as to be inconsequential. In his report, Dr. Jordan stated that "[a]s a matter of policy none of the ... Miller distributors routinely accepted orders and made deliveries to retailers located outside their APRs ... Exceptions to this policy for a given distributor, when compared to the total amount of beer that distributor sold, were rare, unusual, or involved small quantities of beer." These factual assumptions by Dr. Jordan are demonstrably false. While it is true that none of the Miller defendants accepted every order received from retailers outside their APRs, Warren, Hub City, Point Pleasant and MS&W made out-of-territory sales of Miller beer to select retailers on a regular basis. Warren, in particular, routinely sold large quantities of Miller beer to numerous retailers outside its APR throughout the relevant time period. Indeed, Dr. Jordan is able to arrive at his conclusion that "the defendants behaved as though their [Miller] APRs ... were exclusive distribution territories" only by studiously avoiding any reference to the extra-territorial sales of Warren. Warren's estimation that its extra-territorial sales accounted for "more than 5%" of its total sales of Miller beer was known by the plaintiffs at least five months before the release of Dr. Jordan's report. Dr. Jordan cites evidence regarding the sales conduct of each of the other Miller defendants, but apparently chose to deal with the evidence of Warren's extra-territorial sales by ignoring it altogether. In view of Dr. Jordan's selective disregard of significant facts, his ultimate conclusion regarding the parallel conduct of the Miller defendants is entitled to little evidentiary weight.

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[12] Plaintiffs also appear to assume that the only question at issue with regard to their conspiracy claims is whether exclusive territories were established by the brewers or by horizontal agreement among the defendant distributors. By assuming the existence of exclusive territories, plaintiffs fail to address an important difference between the defenses asserted by the A-B defendants on the one hand and the Miller defendants on the other. The A-B defendants readily acknowledge that they treated the APRs assigned by A-B/St. Louis as exclusive distribution territories. The Miller defendants concede only that they concentrated their sales efforts within their respective APRs. They assert, however, that most of them did not treat these areas as being exclusive, as evidenced by their extra-territorial sales.

Plaintiffs have thus failed to generate specific facts from which a jury could reasonably infer parallel conduct by the Miller defendants in furtherance of a horizontal conspiracy to restrain intrabrand competition. The nature and magnitude of the extra-territorial sales of the Miller defendants is manifestly inconsistent with Dr. Jordan's conclusion that the Miller defendants agreed to treat their Miller-assigned APRs as exclusive distribution territories. Plaintiffs have adduced no evidence to support their alternative contention that these extra-territorial sales reflect an agreement among the Miller defendants adjusting the boundaries of their APRs. Nor have plaintiffs produced a single shred of evidence to challenge the inference that these sales were the product of intrabrand competition.

Proof of the existence of parallel conduct is a threshold requirement to establishing antitrust liability under a theory of conscious parallelism. See Schoenkopf, 637 F.2d at 208. As a result of plaintiffs' failure to present evidence showing a genuine factual issue as to this essential element of their case, summary judgment on their conspiracy claims against the Miller defendants is fully warranted. As the Supreme Court stated in Celotex:

> [T]he plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial. In such a situation, there can be "no genuine issue as to any material fact," since

> a complete failure of proof concerning an essential element of the nonmoving party's case necessarily renders all other facts immaterial.

106 S. Ct. at 2553.

b. Conduct Against Economic Self-Interest

The Miller defendants readily admit that they concentrated their sales efforts in their respective Miller-assigned APRs. Although Warren, Hub City, MS&W and Point Pleasant sold Miller beer to retailers located outside their APRs on a regular basis, the vast majority of their sales were made within the boundaries of their APRs. Kristen made no deliveries of Miller beer outside its APR, and only a small fraction of its total sales were made to members of co-ops located outside its APR. Trip briefly made *de minimis* sales to a single retailer outside its APR. Hub Beer, South Jersey and Garden State made no sales or deliveries outside their APRs. Even if these facts were considered to be sufficient for purposes of raising a material issue as to the parallel conduct of the Miller defendants, plaintiffs must also present evidence showing that this conduct was contrary to the economic self-interest of the Miller defendants.

As with the A-B defendants, plaintiffs argue that the Miller defendants acted against their self-interest by failing to take greater advantage of profitable sales opportunities outside their respective APRs.[13] As did the A-B defendants, the Miller defendants contend that they confined their sales to their Miller territories to the extent that they did because they were unwilling to jeopardize their long-term relationship with Miller. As with the defenses asserted by the A-B defendants, the reasonableness and plausibility of the independent business justification for refraining from more extensive extra-territorial sales proffered by the Miller defendants must be similarly evaluated by reference to evidence relating to three pertinent questions: 1) Did Miller have a corporate policy against sales by its designated distributors outside their assigned APRs; 2) How effectively was this policy communicated to the Miller defendants; and 3) Was the Miller defendants' purported fear of brewer sanctions for deviating from this policy justified under the circumstances?

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[13] Plaintiffs attribute the same conduct described in Section V.A.1.c. of this opinion to both the A-B and Miller defendants

With regard to the first of the above questions, Leonard Goldstein, Senior Vice-President of Marketing for Miller, testified that Miller has a longstanding policy preference that its designated distributors confine sales to their assigned territories.

> [W]e look upon our distributors, we looked upon our distributors at that time, we look upon our distributors today as a marketing extension of the brewery's effort in each area of the State of New Jersey, that is, in each area of primary responsibility ... [W]e felt very strongly that it was to our mutual benefit for [our distributors] to confine their efforts to their area of primary responsibility

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and the description of this conduct will not be repeated here. In addition, the law and commentary thereon set forth in Section V.A.1.c. is fully applicable to the present discussion and will not be reiterated.

This policy preference for territorial exclusivity was unmistakably conveyed in the 1983 Miller Distributor Agreements. Under these agreements, each distributor was contractually bound not to "sell or supply Miller products within another authorized Miller distributor's area." The fact that this policy substantially predated 1983 is evident in the contracts between Miller and certain of the Miller defendants which were executed prior to the Supreme Court's decision in Schwinn. In 1953, Kristen entered into a contract with Miller which specified that "[t]he Distributor is to (a) sell and promote the sale of Miller [products] ... in the [territory described in Exhibit A to the agreement] to the satisfaction of Miller; ... and (g) not sell outside such territory ... without the prior written approval of Miller." This contract was superseded by a letter agreement dated May 3, 1954 which stated that "[Miller] will sell to [Kristen] Miller beer for resale in the territory described at the end of this letter with the understanding that [Kristen] will expend [its] best efforts in distributing and selling the same in such territory." This agreement remained in effect until 1983. Garden State entered into an identical letter agreement with Miller also dated May 3, 1954. Hub City similarly entered into an agreement with Miller in 1955 which obligated Miller only to sell Miller products to Hub City "for resale in the [contractually designated] territory." These contractual provisions clearly reflect Miller's desire and expectation that the distributors confine their sales of Miller products to the assigned areas.

There is no evidence that Miller modified its policy favoring territorial exclusivity following the release of the Schwinn decision in 1967. However, the evidence suggests that in the wake of the Schwinn decision Miller was generally more cautious than A-B/St. Louis in its efforts to communicate this policy preference to its designated distriutors. Miller was not only less insistent than A-B/St. Louis that its distributors refrain from extra-territorial sales, but the substance of its oral and written communications with the Miller defendants regarding such sales was more equivocal in nature.

Unlike the contracts between Miller and Kristen, Garden State and Hub City, the Miller contracts with other of the Miller defendants executed subsequent to the Schwinn decision did not limit the resale of Miller products by the distributors to their assigned territories and did not specifically obligate the distributors to expend their best efforts within such territories. Indeed, the agreements signed by MS&W in July 1977, by Warren in June 1980 and by South Jersey in December 1981 each contained the following language in paragraph 1(i) under the heading "Distributor's Area":

> Nothing herein shall be deemed to restrict Distributor as to where or to whom Distributor may resell Miller beer. The area described is not to be regarded as being exclusively Distributor's "territory" unless so required by applicable law or regulation.

In its oral communications with the Miller defendants, Miller similarly disclaimed any intention of imposing exclusive distribution territories on its designated wholesalers. Thus, while Leonard Goldstein testified that he "personally recommended" to Miller distributors that they confine their marketing efforts to their assigned areas, he further stated that "the people who reported to me would state to a distributor that as independent business people they could sell [Miller] beer wherever their licenses allowed them to."[14] The Miller defendants themselves uniformly testified that they were never told by anyone from Miller that they were not permitted to sell Miller products outside their assigned territories or that they would be penalized by Miller for doing so. In fact, Warren stated in answers to plaintiffs' interrogatories that "prior to May, 1983, Miller communicated on numerous occasions that they did not intend to restrict Warren from selling outside its territory." Unlike the A-B defendants who uniformly asserted that they were restricted by A-B/St. Louis from engaging in extra-territorial sales, all but two of the Miller defendants (excluding Kristen and South Jersey) stated that they were not so restricted by Miller.

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[14] There is evidence that at least on one occasion Miller unambiguously directed one of the Miller defendants to refrain from selling a Miller product outside its assigned territory. Point Pleasant originally sold Lowenbrau beer as an import in a territory slightly larger than its Miller territory. When Miller purchased the rights to Lowenbrau and began brewing Lowenbrau in its own breweries in 1978, Miller instructed Point Pleasant to discontinue its sales of Lowenbrau outside its APR. Point Pleasant complied with this explicit direction from Miller.

Plaintiffs conclude from this evidence that Miller did not care whether the Miller defendants sold Miller products outside their APRs. The record, however, does not permit such a broad generalization. While Miller clearly did not insist that the Miller defendants treat their assigned APRs as exclusive distribution territories, the evidence demonstrates that Miller fully expected its designated distributors to concentrate their merchandizing and marketing efforts within their respective areas and communicated this expectation to the Miller defendants in no uncertain terms.

Miller continually stressed to the Miller defendants the importance of upgrading their sales and servicing performance within their assigned territories. In particular, Miller representatives maintained on-site monitoring of each distributor's performance on an ongoing basis throughout the year. For example, Edward Goracy testified that Miller performed quarterly and annual reviews of Warren's performance during which it evaluated and rated "every facet of [Warren's] operation." Leonard Goldstein emphasized that each distributor's performance was judged solely on the basis of its efforts within its assigned territory. The contracts of MS&W and Warren expressly provided that "[t]he purpose of setting forth ["Distributor's Area"] is to establish a location wherein Miller can make a determination as to Distributor's performance of the obligations assumed by Distributor hereunder." Miller considered a broad range of factors in rating the performance of each distributor, including the total volume of sales within the distributor's area, the total number of active retail licensees being serviced by the distributor within its area, the suitability of the distributor's warehousing facilities, the maintenance by the distributor of proper inventory levels, the number of marketing and sales personnel employed by the distributor, the condition of the distributor's delivery trucks bearing Miller brand markings, and the frequency and quality of the distributor's promotional activities and co-op advertizing. Miller also expected its distributors to provide a wide array of services to their retail accounts, including weekly sales solicitations, 24-hour deliveries on a weekly basis at times convenient to retailers, unloading and stacking delivered products, stock rotation, removing and replacing overage or damaged products, and supplying and positioning point-of-sale advertising materials.

The evidence further shows that Miller often found reasons to be critical of the Miller defendants' performance within their assigned territories, and repeatedly demanded that the distributors implement certain corrective measures to improve their overall performance. Frank Tripucka testified:

> [Miller] constantly monitor[s] [Trip's] selling performance ... [T]hey'll sit there and tell you that ... we feel that you should have another sales manager. You should have additional trucks. You should have a new warehouse ... You should have another merchandizing manager, right on down the line. Every one of these things are evaluated.

Tripucka further stated in an affidavit submitted in support of the present summary judgment motion:

> Miller only judges Trip on its performance in Trip's area assigned by Miller. They constantly criticize our operations. They are always alleging there are not enough management, sales or marketing people to service our existing territory. Whenever Trip would react to one of the criticisms of Miller ..., further criticisms would develop. In other words, Miller constantly demands improved performance.

There is additional evidence that the Miller defendants were sensitive to the performance ratings they received from Miller, and affirmatively responded to Miller's criticisms. For example, by lowering annual performance ratings, Miller was able to pursuade Garden State, Kristen and Warren to hire additional personnel. Agnes Kristen testified:

> Q: Did you increase your sales force after you received that less than satisfactory rating from the brewery?
>
> A: Yes, I did.
>
> Q: Do you recall how much you increased your sales force?
>
> A: I added sales supervisors, I added merchandizing people, I added two salesmen.

Miller similarly prompted Kristen to undertake the major capital expense of upgrading its warehouse by rating Kristen's warehousing facilities as less than satisfactory. Miller was equally as capable of using the carrot as the stick to induce the Miller defendants to improve their ability to service their assigned territories. In 1981, Miller offered to expand Trip's assigned APR to include all of Passaic, Bergen and Hudson counties, but insisted that Trip construct a temperature controlled warehouse as a pre-condition to assigning Trip the additional territory. Trip, like Kristen, made this major capital expenditure with no financial assistance from Miller.

Miller's attitude toward extra-territorial sales by its distributors, as reflected in its equivocal oral and written communications on the subject together with its preoccupation with the distributors' performance within their assigned territories, was susceptible of several equally plausible interpretations by the Miller defendants. Notwithstanding the view of most of the Miller defendants that they were not absolutely restricted by Miller from selling outside their assigned territories, the Miller defendants could have reasonably concluded that Miller would tolerate such sales only if their sales and merchandizing performance within their territories was satisfactory to Miller. Warren, in particular, appears to have adopted this view of its relationship with Miller. Warren engaged in substantial sales of Miller products to members of co-ops and other retailers outside its APR throughout the relevant time period. Warren nevertheless gave priority to servicing retailers wit[illegible] its APR. During periods of peak demand, Warren dramatically reduced the volume of its extra-territorial sales in order to conform to Miller's inventory requirements and assure an adequate supply of Miller products to retailers within its assigned area. Although Miller apparently never overtly complained to Warren about the volume of its extra-territorial sales, Edward Goracy testified that Warren was required on at least one occasion to focus greater attention on its sales and merchandizing efforts within its APR in response to an unsatisfactory rating by Miller for failing to maintain proper inventory levels and meet Miller's sales projections and timetables for Warren's area.

Other of the Miller defendants could have just as reasonably concluded that Miller would not have placed such emphasis on the distributors' performance within their assigned territories unless Miller expected them to confine their sales efforts to these territories. Charles Formosa of Hub Beer, which never sold Miller products outside its Miller-assigned area, stated:

> The message was clear to me that Miller, although technically not restricting Hub Beer from selling outside of its territory, would not be happy if we did so and felt that we could not do a satisfactory job in our territory if we sold out of territory.

The evidence suggests that the Miller defendants had good reason to believe that extra-territorial sales might jeopardize their ability to service their assigned areas in a manner which would be satisfactory to Miller. There is testimony by Leonard Goldstein and statements by Frank Banko to the effect that during the 1970's and until 1981 and during periods of peak demand thereafter Miller did not always have sufficient beer production to provide its distributors with as much beer as they were capable of selling. During such periods, Miller strictly allocated its products among its distributors and, if necessary, cut the orders received from particular distributors. The allocation of each distributor was derived from projected sales to retailers within the distributor's assigned area only. Thus, during such periods of allocation, a distributor's extra-territorial sales necessarily cut into inventory allocated for sales to retailers located within the distributor's APR. As previously noted, Warren was forced to cut back on its extra-territorial sales during summer months because it would not get enough beer from Miller to satisfy retailer demand both inside and outside its APR. Warren's conduct directly contradicts plaintiffs' main contention that the Miller defendants unjustifiably declined to make profitable sales outside their APRs. The fact that Warren was forced to actually reduce its extra-territorial sales during peak demand periods suggests that Warren was taking maximum advantage of sales opportunities outside its APR subject to the availability of Miller products in excess of what it needed to satisfy retailer demand within its APR.

Hub City was confronted directly by Miller with the prospect of running out of Miller products as a result of sales Hub City was making in New York State. Both Leonard Goldstein and James Sigler, General Manager of Hub City, testified about a conversation they had regarding Hub City's sales of Miller products into New York. Hub City had originally begun selling in New York with Miller's approval. Miller subsequently rescinded its approval and advised Hub City to discontinue these sales.

Hub City nevertheless continued to sell into New York State. In a conversation with Sigler several months after Hub City was supposed to have ceased its New York sales, Goldstein told him that Miller knew that Hub City was continuing to make such sales. Goldstein testified:

> I wanted to make him aware of the fact that we held him responsible only for his performance in his area of primary responsibility. I said ... that you have to keep a certain amount of inventory on your floor to supply retailers within your [APR]. If we're in an allocating position or shipping beer in the middle of the summer, I certainly am not going to provide him with beer that's reflective of him transshipping beer to another area, because I have to make sure he has his beer in [his APR] and based on his forecasted ... sales in that area. He can do it out of his area, but if he doesn't cover ... [his assigned] area, we're going to have a big problem.

Sigler similarly stated:

> [Goldstein] told me that he knew that Hub City was making the New York sales; he reminded me that we were on allocation and that everyone was on allocation; and that the allocation was measured in terms of sales in [Hub City's] territory, not New York sales. He indicated that if Hub City ever ran out of beer in its territory to service its customers because of making the New York sales, Miller would look very seriously upon it.

According to Sigler, Hub City stopped making sales into New York as a direct result of this conversation.

Dr. Jordan conceded that just such a conversation would be an incentive for a distributor to confine its sales to its territory. He testified:

> Q. Assume that a distributor is selling outside its territory and is told by the brewer that it might ... not be given a full allocation of beer if it continues to do that,

> do you think that would be an incentive for that distributor to confine its sales to its territory? ...
>
> A. I would agree with you, that if the distributor felt that it was not going to have sufficient beer to sell, that certainly would be a consideration as to whether or not it would sell outside its area of primary responsibility.

Charles Formosa of Hub Beer noted that he "learned the general thrust of the conversation" between Goldstein and Sigler, and that this knowledge "certainly affected [his] decision on behalf of Hub Beer to continue to confine sales to [its assigned] territory..." Dr. Jordan acknowledged that a distributor, such as Hub Beer, would be justified in refraining from making sales outside its APR after learning the substance of the conversation between Goldstein and Sigler.

There is further evidence that the Miller defendants independently evaluated whether expanding sales outside their assigned territories might impair their ability to satisfy Miller's expectations regarding the distributors' in-territory performance. As were other of the Miller defendants, including Trip, Warren and Hub City, Kristen was invited by Miller to make sales of Miller products into New York State during a time when Miller was not directly supplying New York distributors. Unlike the other New Jersey distributors, Kristen declined the invitation preferring instead to concentrate its efforts on servicing retail accounts within its territory. Agnes Kristen explained the rationale for this decision: _

> At that time Kristen's management chose not to make these sales as it was feared that to do so would disrupt the marketing practices and procedures we maintained to assure proper service of our in-area accounts. We believed that any effort out-of-area could cause us to have problems in our next Miller annual review, which would not take into account our increased sales in New York. Although we were aware that sales to New York accounts could yield high, short term profits, we chose to forego these profits in favor of protecting our long term relationship with our in-area accounts.

The record on the present summary judgment motion further supports the inference that it was in the long-term economic self-interest of the Miller defendants to maintain a level of performance within their assigned territories which was satisfactory to Miller. Miller certainly enjoyed as much economic leverage over the Miller defendants as did A-B/St. Louis over the A-B defendants. Miller's contracts with the Miller defendants were terminable at will or for cause. Miller also retained the right to appoint a competing distributor in an existing distributor's territory. Dr. Jordan acknowledged that such an action by Miller could amount to an "effective termination."

Under their contracts with Miller, the Miller defendants were obligated either to expend their "best efforts in distributing or selling" Miller products or to "market and promote actively and aggressively the sale of Miller beer." As plaintiffs' economic experts conceded, Miller was the final arbiter as to whether the Miller defendants were satisfying these vague contractual requirements. The extent of Miller's discretion with regard to measuring distributor performance and exercising its termination rights clearly placed the Miller defendants in a vulnerable economic position. As James Sigler stated:

> In my view, Hub City always did a good job in its primary area, but Miller nevertheless regularly graded Hub City at just the satisfactory level. I was always concerned that if Miller wanted to find something wrong, it could do so by simply letting the rating slip in one or two areas, thus bringing the entire rating below satisfactory and endangering the whole franchise.

The vulnerability of the Miller defendants was accentuated by the fact that the sale of Miller products by each of the Miller defendants except Warren represented between 80% and 90% of their total sales during the relevant time period. Approximately half of Warren's total sales were attributable to Miller products. Under these circumstances, the loss of their right to distribute Miller products would have had a potentially devastating impact on the business of each of the Miller defendants.

The risk of sanction by Miller for the failure of a distributor to maintain a level of performance satisfactory to Miller was neither illusory nor hypothetical. Indeed, the Miller defendants had ample reason to believe that a poor performance rating of a distributor could result in termination of its contract with Miller or the appointment by Miller of a competing distributor in its territory. In 1975, Miller specifically appointed Warren to sell Miller products in the territory of another designated distributor, the Carlo Gelardi Distributing Co. ("Gelardi"). Leonard Goldstein testified:

> [Miller was] very much concerned about a rapid deterioration of [Gelardi's] performance in [its] area of primary responsibility. In our regional office in New York we were receiving a proliferation of phone calls from retailers about very poor service. [Gelardi] was not able to pay [Miller] on time for the beer that [it] received. [Gelardi] had a very poor experience with us as far as maintaining required inventory. [Gelardi] had indicated to us that [it] was shipping beer out of [its] territory.

Miller subsequently terminated its distributorship agreement with Gelardi in 1976, leaving Warren as the sole distributor of Miller products in the area. See generally, Carlo C. Gelardi Corp. v. Miller Brewing Co., 502 F. Supp. 637 (D.N.J. 1980). Gelardi subsequently went out of business. In addition to Warren, Kristen and Hub City knew that Gelardi sold Miller products outside its APR, that Miller appointed Warren to serve the same area as Gelardi, and that Gelardi was ultimately terminated by Miller and was no longer in the beer distribution business. Dr. Jordan acknowledged that Miller distributors who were aware of Miller's actions against Gelardi could have reasonably concluded that these actions were taken as punishment for Gelardi's sales outside its APR and its resultant inability to adequately service its territory to the satisfaction of Miller.

The evidence presented on the present summary judgment motion supports a conclusion that the Miller defendants were responding to the vertical direction of Miller when they refrained from engaging in more extensive extra-territorial sales. Unlike A-B/St. Louis, Miller did not expressly direct the Miller defendants to confine their sales of Miller products to their respective APRs, and the evidence correspondingly shows that, unlike the A-B defendants, most of the Miller defendants did not treat their assigned APRs as exclusive distribution territories. Miller did, however, impress upon the Miller defendants the importance of maintaining a level of performance within their APRs which was satisfactory to Miller, and the evidence correspondingly shows that each of the Miller defendants concentrated its merchandizing and marketing efforts within its APR and took steps to assure that any extra-territorial sales it made would not interfere with these efforts. Lastly, Miller had considerable discretion in terms of evaluating the adequacy of a distributor's performance within the distributor's APR and in terms of exercising its powers of appointment and termination, and the evidence correspondingly shows that the Miller defendants repeatedly adjusted their business behavior in response to the criticisms, demands and expectations of Miller.

There is also an abundance of evidence to support the inference that each of the Miller defendants independently evaluated its own long-term business relationship with Miller and the potential risks to that relationship in deciding whether to and how much to sell out of area. Kristen, Garden State and Hub City were subject to virtually identical contractual agreements with Miller, yet Hub City routinely sold Miller products outside its APR, whereas Kristen made no extra-territorial deliveries of Miller beer and Garden State neither sold nor delivered Miller products outside its APR. Similarly, despite identical contracts with Miller, Warren engaged in extensive extra-territorial sales while South Jersey made none. In a different yet equally significant vein, Miller invited four of the Miller defendants to make sales in New York State, but only Kristen declined the invitation. The disparate behavior of the Miller defendants is precisely what would be expected of independent businesses making independent decisions in accordance with their perceived economic self-interest. Indeed, the very fact that there was such variation among the Miller defendants in terms of extra-territorial sales strengthens the inference that they were separately evaluating the extent to which they could engage in such sales while continuing to service their assigned territories in conformity with Miller's expectations

In short, the Miller defendants have offered sound business reasons for confining sales to their respective APRs, to the extent that they did. Thus, even if plaintiffs could prove that the Miller defendants did not take advantage of profitable sales opportunities outside their assigned territories, this proof would be insufficient to allow a jury to find action in contradiction of the Miller defendants' economic self-interest. Each of the Miller defendants is entitled to summary judgment on plaintiffs' conspiracy claims.

B. Proof of Impact

Under the second essential element of proof in a Section 1 case, antitrust plaintiffs must produce sufficient evidence from which the trier of fact can infer a causal connection between the alleged antitrust violation and the injury plaintiffs are alleged to have sustained. Continental Ore Co. v. Union Carbide & Carbon Corp., 370 U.S. 690, 700 (1962). As the Supreme Court has stated:

> [Plaintiffs] must prove more than injury causally linked to an illegal presence in the market. Plaintiffs must prove antitrust injury, which is to say injury of the type the antitrust laws were intended to prevent and that flows from that which makes defendants' acts unlawful. The injury should reflect the anticompetitive effect either of the violation or of anticompetitive acts made possible by the violation. It should, in short, be "the type of loss that the claimed violations ... would be likely to cause."

Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc., 429 U.S. 477, 489 (1977). Summary judgment is appropriate if antitrust plaintiffs fail to present specific facts which tend to show that the alleged anticompetitive acts were a material cause of injury to plaintiffs' business or property.

> [T]here are patently justifiable reasons why a trial court should ascertain, before embarking on a lengthy antitrust trial, whether plaintiff will be able to present some evidence that the injury of which it complains can be attributable to the alleged antitrust violation.

Out Front Productions, Inc., v. Magid, 748 F.2d 166, 170-71 (3d Cir. 1984), citing Van Dyk Research Corp. v. Xerox Corp., 631 F.2d 251, 258 (3d Cir. 1980) (Sloviter, J., concurring), cert. denied, 452 U.S. 905 (1981).

The only form of antitrust injury to their business or property that plaintiffs have alleged in this action is that plaintiffs "have been required to pay higher prices for beer which they have purchased ... from the defendant distributors" as a result of the horizontal agreements to maintain exclusive distribution territories. In support of their present summary judgment motions, the A-B and Miller defendants contend that high levels of interbrand competition effectively precluded any anticompetitive effects on the wholesale pricing of A-B and Miller products that could have potentially resulted from the elimination of intraband competition through exclusive distribution territories.

The Supreme Court has recognized that exclusive territories are not inherently anticompetitive. In Sylvania, the Court analyzed the relationship between interbrand and intrabrand competition and noted that interbrand competition can minimize and under certain circumstances neutralize the potential anticompetitive effects of exclusive territories.

> Interbrand competition is the competition among the manufacturers of the same generic product ... and is the primary concern of antitrust law .... In contrast, intrabrand competition is the competition between the distributors -- wholesale and retail -- of the product of a particular manufacturer.
>
> The degree of intrabrand competition is wholly independent of the level of interbrand competition confronting the manufacturer. Thus, there may be fierce intrabrand competition among the distributors of a product produced by a monopolist and no intrabrand competition among the distributors of a product produced by a firm in a highly competitive industry. But when interbrand

> competition exists, ... it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.

433 U.S. at 52 n.19. Thus, the critical question in the present case is whether interbrand competition among distributors of beer in New Jersey served as an effective substitute for intrabrand competition and prevented the A-B and Miller defendants from artificially raising the wholesale price of beer to retailers above competitive levels.

The ability of a business entity to unilaterally raise its prices above competitive levels is typically referred to as "market power."[15] As then Professor, now Judge Posner has explained:

> The absence of market power in the interbrand market implies that the defendant is in competition with firms that sell products regarded as close substitutes for the defendants. The defendant therefore will lose most or all of its sales if its retail price exceeds its competitors' retail price for any reason ... [I]f a firm lacks market power, it cannot affect the price of its product; that price is determined by the market.

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[15] The concept of market power has typically been applied in monopolization cases brought under § 2 of the Sherman Act, *see, e.g.*, *United States v. Grinnel Corp.*, 384 U.S. 563 (1966), merger cases under § 7 of the Clayton Act, *see, e.g.*, *United States v. Philadelphia Bank*, 374 U.S. 321 (1963), and post-*Sylvania* cases under § 1 of the Sherman Act challenging vertical geographic restraints under a rule-of-reason analysis, *see, e.g.*, *Assam Drug Co., Inc. v. Miller Brewing Co., Inc.*, 798 F.2d 311, 315-17 (8th Cir. 1986. However, the market power concept is equally applicable in analyzing the potential for monopoly pricing of A-B and Miller products in the wholesale malt beverage market in New Jersey by the defendants in this case.

Posner, The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality, 48 U.Chi.L.Rev. 6, 16 (1981), quoted in Graphic Products Distributors v. Itek Corp., 717 F.2d 1560, 1569 (11th Cir. 1983). Market power is not something a given firm simply has or does not have, but rather is a matter of degree. As Professor Areeda has noted:

> The degree of market power may be extremely small, as when any more than a slight increase in price would lead to an unacceptable loss of sales. It is substantial where a firm can raise price substantially without a significant profit decline resulting from competitors' increased output or lower prices or from consumer resistance at the higher price.

Areeda, supra. ¶ 501 at 322-23. For purposes of the present discussion, "market power" will be used to refer to the ability of the defendants to effect a unilateral price increase without having the profit realizable from the price increase offset by a corresponding decline in consumer demand. For plaintiffs to show that interbrand competition in the wholesale malt beverage market in New Jersey was not a complete substitute for intrabrand competition, plaintiffs must present facts which support the inference that the A-B and Miller defendants had sufficient market power to implement and profit from unilateral price increases above competitive levels.

Several economic factors are particularly relevant in determining the market power of antitrust defendants.

> Market power ... is a function of one or both of two principal interrelated economic criteria -- market share and product differentiation. The market share of the product on which the intrabrand restraint is

> imposed and the degree to which that product is insulated from competition by product differentiation directly relate to the effectiveness of interbrand competition in minimizing the effects of the restraint on intrabrand competition.

ABA Antitrust Section, Monograph No. 2, Vertical Restrictions Limiting Intrabrand Competition, 62-63 (1977) (hereafter referred to as "ABA Monograph").

With regard to the first of these factors, if a particular brand has a small share of the relevant market, restraints on competition among sellers of that brand are not as likely to lead to anticompetitive effects on overall competition as they would if the brand commands a substantial share of the market. "[A] substantial market share suggests that interbrand competition may not be an effective competitive check." Id. at 63. The degree of market concentration is also a relevant consideration in determining whether interbrand competition is likely to serve as an effective substitute for intrabrand competition.

> [T]he existence of competing producers of identical products will not insure the absence of effective market power if the number of producers is so few that each elects to abide by a non-competitive price and share in the resulting monopoly profits -- the oligopoly case.

Areeda, supra, at ¶ 504a; see also ABA Monograph at p.64.

With regard to the second factor of product differentiation, Judge Learned Hand noted that "substitutes are available for almost all commodities, and to raise the price enough is to evoke them." United States v. Aluminum Company, 148

F.2d 416, 426 (2d Cir. 1945). Product differentiation can be characterized as the extent to which different brands of the same products are regarded by consumers as substitutes for one another. Products differentiation is a function of consumer perceptions of brand quality and desirability which are influenced by styling, packaging, advertising, servicing and other forms of non-price competition. See ABA Monograph at p.64. The level of product differentiation will depend on how close the substitutes are in the minds of consumers and how many consumers consider them to be close. See Areeda, supra, at ¶ 504b. This market phenomena is measured in terms of cross-elasticity of demand; that is, the responsiveness of the sales of a product brand to price competition from other brands. See ABA Monograph at p.65. If there is a low level of product differentiation with respect to a particular product within a defined market (i.e., a low level of consumer brand loyality to A-B and/or Miller beer product in New Jersey), then an increase in the price of a particular brand above competitive levels would result in a corresponding reduction in demand for that brand as consumers shift to other brands. In such a circumstance, the producer or distributors of that brand would lack significant market power, and "interbrand price competition can be considered effective." Id.

A number of courts have focused entirely on the market share of a product brand subject to restraints on intrabrand competition as the sole determinant of whether the manufacturer of the brand has market power. See, e.g., Assam Drug Co., Inc. v. Miller Brewing Co., Inc., 798 F.2d 311, 318-19 (8th Cir. 1986); Valley Liquors, Inc. v. Renfield Importers, Ltd., 678 F.2d 742, 745 (7th Cir. 1982). As noted by the Eleventh Circuit:

> Market share is frequently used in litigation as a surrogate for market power for two reasons. First, market power is conceptically difficult to define in any given case. Second, its measurement requires sophisticated econometric analysis.

Graphic Products Distributors, Inc. v. Itek Corporation, 717 F.2d 1560, 1570 (11th Cir. 1983). Although market share calculations have the advantage of being easily quantifiable, reliance on this singular economic indicator of market power appears to be misplaced. Prof. Timothy Bresnahan, another of plaintiffs' economic experts has noted:

> [M]arket shares are misleading indicators of firm market power in the brewing industry ... [M]arket share is a poor indicator of firm market power in a product differentiated industry because there is no reason to expect that the firms with the largest shares of industry sales will also have the greatest fraction of inframarginal customers ... [A] small firm can have a substantial amount of market power while, at the same time, a large firm can have little or no market power.[16]

Bresnahan, An Analysis of the Competitive Effects of a Heileman-Pabst Merger, 4, 7 & 9 (November 16, 1984); see also Areeda, supra, ¶ 507. Thus, in order to determine the market power of the A-B and Miller defendants, evidence relating to both market share and product differentiation should be independently evaluated.

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[16] Under Bresnahan's analysis, marginal customers are those who will readily switch to substitute brands of a product in reaction to a price increase. Inframarginal customers, by contrast, are those who more strongly prefer the brand and will switch to substitutes only at higher price increases.

1. Market Share

A market share analysis of beer sales in New Jersey between 1979 and 1982 strongly suggests that Miller and the distributors of its brands were without significant market power. During this time period, the market share of Miller beer brands ranged from 21.1% to 17.3%. The Eighth Circuit has recently held that a market share of 19.1% of the South Dakota interbrand beer market did not confer market power on Miller. *Assam Drug Co., Inc.*, 798 F.2d at 318-19; *see also* *Donald B. Rice Tire Co*, 483 F. Supp. 750 (D. Md. 1980) (20-25% market share does not constitute market power), *aff'd*, 638 F.2d 15 (4th Cir.), *cert. denied*, 454 U.S. 864 (1981); *O.S.C. Corp. v. Apple Computer, Inc.*, 601 F. Supp. 1274 (C.D. Cal. 1985) (up to 20% market share does not constitute market power where substantial competition exists), *aff'd*, 792 F.2d 1464 (9th Cir. 1986). Of equal significance is the fact that Miller's market share was steadily declining during the relevant time period (21.3% in 1979, 19.6% in 1980, 18.4% in 1981, and 17.3% in 1982). As noted by the ABA section on Antitrust Law, "a declining market share ... would appear to indicate a reduced need for intrabrand competition, because the effectiveness of interbrand competition is clearly established." ABA Monograph at 63.

A review of the market share enjoyed by A-B during this time period is less conclusive. Between 1979 and 1982, the market share of A-B brands ranged from 45% to 48.4%. Although substantial, such large shares of the New Jersey beer market does not necessarily reflect per se market power. See Graphic Products Distributors, Inc. v. Itek Corp., 717 F.2d 1560, 1568-71 (11th Cir. 1983) (70-75% market share is indicative of market power where only a small number of competing firms divided the remaining 25-30%). Indeed, during the relevant time period, A-B's market share was steadily inceasing (45% in 1979, 46.9% in 180, 47% in 1981 and 48.4% in 1982). Even assuming that A-B and its distributors enjoyed some degree of market power with such large shares of the market, it is unlikely that A-B could have captured progressively larger shares of the beer market if its distributors were simultaneously setting the prices of A-B brands above competitive levels. One of the economic experts of the A-B defendants, Dr. Myslinski, has noted that "[i]ncreasing market share of a leading firm is also consistent with aggressive price and non-price competition. If prices are above competitive levels, the leading firm will lose market share over time." Myslinski Report at 40, citing G. J. Stigler, "a Theory of Oligopoly," J. Pol. Econ. (Feb. 1964), and R. A. Posner, Antitrust Law: An Econbmic Perspective, 62 (1976).

Plaintiffs argue that the combined market shares of the A-B and Miller defendants are the correct index of market power. Although plaintiffs have abandoned their claims regarding a joint conspiracy among the A-B and Miller distributors to maintain exclusive distribution territories, they contend that the existence of parallel conspiracies to restrain intrabrand competition enabled the A-B and Miller defendants to increase the price of their respective brands higher than they could have if only one group of distributors had entered such a conspiracy. In support of this proprosition, plaintiffs rely on a so-called "feedback theory" advanced by Bresnahan and Stiglitz. According to plaintiffs' experts, the existence of similar conspiracies among distributors of the two leading brands in New Jersey removes much of the restraining influence on price that each group of distributors would otherwise exert on the other group's prices. Stiglitz Report at 9; Bresnahan II Report at 22-23. Thus, after these feedback effects have worked, the prices of both brands will finally be higher than either of them would have been if only the distributors of one brand had conspired to maintain exclusive territories.

Plaintiffs' experts do not offer any empirical evidence or cite to any empirical studies to support their feedback theory. They do not provide a pricing history of A-B or Miller products in New Jersey showing a pattern of corresponding price increases. Nor have they produced any evidence that the wholesale price of A-B and Miller brands increased disproportionately to the price of beer generally or the wholesale price of other brands in particular.[17] Dr. Myslinski asserts that plaintiffs' "feedback effect" is neither obvious nor inevitable as a matter of economic theory.

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[17] Nor do Bresnahan or Stiglitz attempt to argue that there was oligopolistic pricing behavior among distributors of all brands

> In addition to responding to an increase in a competitor's price with a price increase of its own, it is also possible that consumer sensitivity to price changes may dictate that a firm's best strategy could be either to leave its price unchanged or to lower its price so as to pick up even more of its competitor's former customers.

Myslinski Report at 69. Indeed, under the circumstances of this case, it would have been economically irrational for the Miller defendants to have acted in a manner consistent with plaintiffs' "feedback effect" theory. It is unlikely that the Miller defendants would have followed non-competitive price increases in A-B brands at a time when the market share of Miller brands was declining. Rather, it is more probable that the Miller defendants would have taken advantage of the opportunity to recoup lost market share by resisting such increases and maintaining the prices of Miller beer at competitive levels.

Absent facts supporting plaintiffs' "feedback effect" theory, the separate market shares of Miller and A-B brands in the New Jersey beer market are the appropriate percentages to be considered in assessing the respective market power of the Miller and A-B defendants. These market shares standing alone do not support a conclusion that the Miller and A-B defendants had

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of beer in New Jersey.

sufficient market power to effect unilateral price increases above competitive levels without suffering an offsetting decline in consumer demand.

2. Product Differentiation

The A-B and Miller defendants have produced considerable evidence from which it can reasonably be inferred that customer loyalty to the A-B or Miller brands, to the extent that it existed, was extremely shallow and that the level of product differentiation at the consumer level in New Jersey was so low as to preclude the A-B and Miller defendants from exercising market power over the pricing of their respective products. In particular, defendants' economic experts have presented precise statistical data which tends to show: (a) that the overall market share of A-B and Miller brands in New Jersey shifted dramatically between 1978 and 1982, see Myslinski Report at 43;[18] (2) that the relative shares of sales of competing A-B and Miller brands by competing A-B and Miller distributors were highly unstable between 1978 and 1982, see Myslinski Report at 43-44; (3) that New Jersey retailers were extremely sensitive to changes in the wholesale price of A-B brands and adjusted their purchasing behavior accordingly, see Myslinski Report at 44-50;[19]

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[18] The Federal Trade Commission noted in a 1978 study that "large changes in market shares in many states are evidence," that consumers of beer apparently do not "display a great deal of brand loyalty." Bureau of Economics, Federal Trade Commission, The Brewing Industry at 130 (1978).

[19] For example, in Table 7 in his report, Myslinski shows the percent of 1982 volume for Budweiser 12 ounce can/six packs sold by each A-B distributor in New Jersey during promotional price

and (4) that during the relevant time period there were significant monthly and tri-monthly fluctuations in market share between competing A-B and Miller distributors beyond what one would find from monthly price promotions, see Finneman Aff., ¶¶ 32-40 and Tables 3, 3A and 4. This data supports the conclusions of defendants' economic experts that there was intense interbrand competition in the New Jersey wholesale malt beverage market during the relevant time period and the price elasticity of demand for Miller and A-B brands at the retailer and consumer levels of this market in New Jersey was such that the Miller and A-B defendants were effectively precluded from raising wholesale prices above competitive levels. Defendants further note that these conclusions were corroborated by virtually every retailer that has testified in this action. For example, Frank E. Gibson testified:

> I'm sure that one month Miller gives a discount and the next month Budweiser gives a discount. The consumers are very aware of it today. The loyalty to products is gone. If you put Anheuser-Busch out on sale they buy Aneuser-Busch. If you put Miller out on sale, they will buy Miller .... It's taken a few years since this deregulation, but now the public is extremely aware of price, extremely.

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months as follows:

Distributor	Percent
Crown	60.2 (1981)
Harrison	35.5
High Grade	54.3
Konrad	42.1
A-B Newark	46.7
Ritchie & Page	36.3

Plaintiffs and their experts have not attempted to refute the data presented by defendants' economic experts. Rather, plaintiffs' economic experts rely on theoretical assumptions regarding the market power of the A-B and Miller defendants in the absence of intrabrand competition for which they provide very little factual support. In particular, Drs. Stiglitz and Bresnahan conclude on the basis of broadly-defined economic principles that the elimination of intrabrand competition resulting from exclusive distribution territories (whether vertically or horizontally imposed) will always result in reduced competition and higher prices for the brand in question.

Bresnahan insists in his second report that "[i]f raising the price of either of the two brands above its competitive level while leaving the prices of all other brands at their competitive level would not make demand for that brand fall to zero, then interbrand competition alone will lead to higher prices than intrabrand competition." Bresnahan II at 21. In effect, Bresnahan assumes that for interbrand competition to be a complete substitute for intrabrand competition, any price increase of a particular brand above competitive levels would have to reduce consumer demand for that product to zero; that is, there must be no product differentiation at the consumer level. He does not attempt to justify such an extreme assumption nor explain why a total absence of consumer brand loyalty is necessary for interbrand competition to be effective. Common sense would seem to suggest otherwise. As a matter of simple logic, it would follow that no rational businessperson would increase prices above competitive levels if even a slight increase would cause enough consumers to shift to other brands so that the loss of sales more than offset the profit to be derived from the price increase. There is no reason to assume that a total withdrawal of consumer demand is necessary to deter such noncompetitive pricing. Indeed, in a previous work Bresnahan acknowledged that "[t]o an economist, a firm has market power only if it is able to raise price without losing so many sales as to cause the price increase to reduce sales revenue." Bresnahan, An analysis of the Competitive Effects of a Heileman-Pabst Merger 26 & 27 (November 1984). Bresnahan makes no attempt to show in his present report that such a reduction would not have occurred if the A-B or Miller defendants raised the wholesaler prices of A-B or Miller brands above competitive levels. Indeed, in two prior studies of competition in the brewing industry (including the one cited above), Bresnahan's analysis supports just the opposite conclusion.

In his analysis of the proposed Heileman-Pabst merger, Bresnahan concluded that there was intense interbrand competition in the brewing industry. *Id.* at 1.[20] Bresnahan further noted that a marketing study conducted by the G. Heileman Brewing Company had shown that "many Miller High Life drinkers are marginal" (i.e., many of the purchasers of the flagship Miller brand would switch to other brands if the price of Miller High Life were increased above competitive levels). Id. at 19. Brenahan also observed that "it appears that enough customers of A-B's brands are marginal with other firms' brands so that the rest of the industry as a whole constrains A-B from exercising market power ..." Id. at 31. In a separate study, Bresnahan and a co-author concluded that A-B had no market power at the consumer level over the twenty year period of 1962-82:

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[20] A number of other studies of the beer industry reached similar conclusions. A staff report of the FTC Bureau of Economics concluded that "the weight of the evidence supports the view that the [beer] industry has actually become more competitive and that, in general, performance has been good." Bureau of Economics, Federal Trade Commission, *The Brewing Industry* at 1 (1978). Similarly, Dr. Kenneth Elzinga, after an intensive study of the beer industry, concluded:

> Anheuser-Busch had some market power in the early part of the sample, but lost all its market power when Miller introduced a light beer nationwide in 1975 ... Miller's innovation destroyed that market power.

J. Baker & T. Bresnahan, Estimating the Elasticity of Demand Facing a Single Firm: Evidence on Three Brewing Firms, Research Paper No. 54. Stanford Workshop on Factor Markets, at ii and 41

> The statistics on the structure of the beer industry, the pricing and marketing conduct oif its members, and the profits it has received do not mark it as a monopolized industry. The extent of exits from brewing in the last decade indicate that this is hardly an industry in which an inefficient producer is protected from the chilling winds of competition.

Elzinga, "The Beer Industry," The Structure of American Industry, 246 (W. Adams, 6th ed. 1982).

(June 1984). Bresnahan and his colleague based this conclusion on their econometric estimate of an extremely high elasticity of demand for A-B products at the consumer level. Id.

Bresnahan's prior empirical work demonstrates that although beer is a differentiated product (i.e., consumers have some degree of preference for particular brands), consumers view other brands of beer as very close substitutes for A-B and Miller brands on a nationwide basis.[21] Significantly, Bresnahan makes no attempt in his two reports submitted in this case to distinguish the market conditions existing in New Jersey between 1978 and 1982 from those which led him to reach his prior conclusions regarding the lack of A-B or Miller market power on a national level.[22] As a result, Bresnahan's prior studies suggest that the A-B and Miller defendants could not have sustained prices for A-B and Miller products above competitive levels without sustaining a net loss in sales revenue, effectively precluding any anticompetitive impact, particularly in the form of higher prices, as a result of exclusive territories.

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[21] Bresnahan notes in one of his present reports that retailer demand directly reflects consumer demand. Thus, any conclusions regarding the market power of A-B or Miller at the consumer level will extend to the retail/wholesale distribution level as well. See Bresnahan II at 25.

[22] Plaintifs have attempted to draw certain distinctions in their papers in opposition to the present summary judgment motions. They note that the New Jersey market was more highly concentrated than the nationwide market analyzed by Bresnahan in his prior studies. In particular, they highlight the small number of distributors of A-B brands in New Jersey as contrasted with the total number of such distributors nationwide. While the small number of A-B distributors in New Jersey might be relevant in assessing the potential for collusion among them in forming a conspiracy to restrain intrabrand competition (discussed infra), it is the total number of distributors of all brands of beer operating in New Jersey which is the relevant consideration in determining whether the wholesale interbrand beer market is so concentrated as to allow anti-competitive pricing practices by the Miller and A-B defendants. Plaintiffs offer no facts regarding total numbers of competing distributors.

Dr. Stiglitz also relies on broad economic assumptions regarding the anticompetitive effects of exclusive distribution territories for which he offers no factual support. Stiglitz notes that "[i]n a market without exclusive territories distributors face competition from several sources: (a) from other beverages ...; (b) from distributors of other beers; and (c) from other distributors of the same beer(s)." Stiglitz Report at 6. Stiglitz also notes that "[w]hen [firms] raise their prices, they lose sales for three reasons: each customer may purchase less; customers may be lost to other sellers of the same brand; and some customers may switch brands." Id. at 7. He observes that exclusive distribution territories "serve to remove one of the major sources of competition" and further "reduces ... one of [the] three sources of losses of sales." Id. at 6 and 7. Stiglitz concludes that exclusive territories will always lead to higher prices than would otherwise exist in the absence of such restraints on intrabrand competition.

The simplicity of Stiglitz's syllogistic argument has a certain superficial appeal, and at first glance his conclusion appears self-evident. However, on closer inspection, it is apparent that Dr. Stiglitz has merely assumed without factual basis the very conclusion which is at issue here; that is, that the A-B and Miller defendants had sufficient market power to effect unilateral price increases above competitive levels without suffering an offsetting loss of consumer demand to other brands. This assumption is contradicted by the statistical data presented by defendants' economic experts as well as the prior studies conducted by Dr. Bresnahan.

I conclude that the economic assumptions of Drs. Bresnahan and Stiglitz contained in their respective reports submitted on behalf of plaintiffs in this case do not by themselves generate an issue of material fact on the question of the anticompetitive impact of exclusive distribution territories. Plaintiffs argue that summary judgment is inappropriate in the face of the conflicting opinions of the plaintiffs' and defendants' economic experts. They assert that the mere presence of conflicting expert opinions demonstrates that there exist genuine issues of fact with regard to the impact issue. However, Fed.R.Evid. 703 does not automatically preclude the granting of summary judgment any time an expert for an antitrust plaintiff expresses an opinion on a factual issue which the plaintiff has the burden of proving at trial. In Merit Motors, Inc. v. Chrysler Corp., 569 F.2d 666 (D.C. Cir. 1977), the court, speaking through Judge J. Skelly Wright, emphasized that under Rule 703 the factual predicate of an expert's opinion must find some support in the record. The court reasoned:

> To hold that Rule 703 prevents a court from granting summary judgment against a party who relies solely on an expert's opinion that has no more basis in or out of the record than ... theoretical speculations would seriously undermine the policies of Rule 56. We are unwilling to impose the fruitles expenses of

> litigation that would result from such a limitation on the power of a court to grant summary judgment.

Id. at 673; quoted with approval in Pennsylvania Dental Association v. Medical Service Association of Pennsylvania, 745 F.2d 248, 262 (3d Cir. 1984).

There is substantial evidentiary support for the opinions of defendants' economic experts that intense interbrand competition in the New Jersey malt beverage market effectively constrained the A-B and Miller defendants from raising the wholesale prices of A-B and Miller brands above competitive levels. The only empirical support for plaintiffs' contention that restraints on intrabrand competition enabled the A-B and Miller defendants to charge New Jersey beer retailers supracompetitive prices for A-B and Miller brands is offered in the yardstick comparison of the pricing of these brands in New Jersey and Indiana performed by Dr. Bresnahan. Thus, plaintiffs' claim of antitrust impact must rise or fall on the evidentiary weight to be accorded Bresnahan's yardstick analysis, which is discussed in the following section on damages.

C. Damages

The third element plaintiffs must prove to establish their antitrust claim is the amount of damages suffered as a result of the alleged antitrust violation. See American Bearing Co. v. Litton Industries, 729 F.2d 943, 948 (3d Cir.), cert. denied, 105 S.Ct. 178 (1984); Deaktor v. Fox Grocery Co., 475 F.2d 1112, 1116 (3d Cir.), cert. denied, 414 U.S. 867 (1973). To sustain this burden "[t]he plaintiff must ... show the amount of damages which have been suffered, using a reasonable method of computation." Martin B. Glauser Dodge Co. v. Chrysler Corp., 418 F. Supp. 1009, 1019 (D.N.J. 1976), rev'd on other grounds, 570 F.2d 72 (3d Cir. 1977), cert. denied, 436 U.S. 913 (1978). Recognizing the unique difficulties in proving damages in antitrust cases, the Supreme Court has relaxed the usual standard of definiteness in establishing the amount of damages. See, e.g., Bigelow v. RKO Radio Pictures, 327 U.S. 251, 264 (1945). As Prof. Areeda has noted:

> If [the] public function of private damage actions is not to be frustrated, courts must not insist upon unduly rigorous proof of the quantum of the plaintiffs injury, for the marketplace usually denies us sure knowledge of what plaintiff's situation would have been in the absence of the defendant's antitrust violation.

Areeda, supra at ¶ 343. A jury is permitted to "make a just and reasonable estimate of the damage based on relevant data, and render its verdict accordingly." Bigelow, 327 U.S. at 264. In reaching its decision, a jury is "allowed to act upon probable and inferential, as well as direct and positive proof." Story Parchment Co. v. Paterson Co., 282 U.S. 555, 562 (1931). However, "the jury may not render a verdict based on speculation or guesswork." Bigelow, 327 U.S. at 264.

In a case such as this involving alleged overcharges in the pricing of a particular product resulting from anticompetitive practices, an antitrust plaintiff is permitted to recover the difference between the anticompetitive price and the price that would have been paid in the absence of the anticompetitive arrangement. See Hanover Shoe, Inc. v. United Shoe Machinery Corp., 392 U.S. 481, 489-90 (1968).

The A-B and Miller defendants contend that the overcharges calculated by plaintiff's economic expert Dr. Timothy Bresnahan are demonstrably the product of his methodology and not, as he maintains, the result of restraints on intrabrand competition. Defendants argue that Bresnahan's Reports can not serve as a factual basis for reaching a "fair and reasonable estimate of damages." I agree for the reasons set forth below and accordingly grant summary judgment in favor of the defendants on the issue of damages.

In Decmeber 1985, Bresnahan's first report (referred to as "Bresnahan I") was served on the defendants. In this report, Bresnahan concluded that the existence of exclusive territories for beer wholesalers in New Jersey substantially raised the price of Miller and A-B products to retailers above the level which would have existed in a truly competitive environment. In order to calculate the amount of the overcharges paid by retailers during the relevant time period of 1979 to 1983, Bresnahan utilized a "yardstick" approach in which he compared the pricing of beer by defendants during this period with the wholesale price of A-B beer charged by a single distributor in Indiana, a state which by regulation prohibits the vertical imposition of exclusive beer distribution territories.[23] Based on his

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[23] A regulation promulgated in 1978 by the Indiana Alcoholic Beverage Commission ("Rule 28") prohibited vertically imposed

"yardstick" comparison, Bresnahan reached the following conclusions quantifying the damages allegedly caused by defendants' horizontal conspiracy to restrain intrabrand competition:

> The actual effect of the distributors' monopoly power was an increase of price over competitive levels estimated at 13.9% using reasonable assumptions about distributors' costs of doing business, or at 7.6% using very conservative assumptions. Under the reasonable percentage overcharge figure of 13.9%, I find that ... [t]he total amount by which retailers were overcharged in the relevant period was $188 millilon. Of this, $57 million is overcharges for Miller brands of beer, and $131 million for A-B brands of beer.
>
> Using the lower-bound estimate of percentage overcharge, 7.6%, I find that ... [t]he amount by which retailers were overcharged in the relevant period exceeded a lower-bound estimate of $102 million. Of this $31 million is overcharges for Miller brands of beer, and $71 million for A-B brands of beer.

Bresnahan I at 31-32.

The oral depositions of Bresnahan was commenced on February 10, 1986. Bresnahan was subjected to intensive examination during which the sufficiency and reliability of the factual basis for his damage calculation was brought into serious question. After three and one half days the deposition was adjourned at the request of defendants who thereafter filed motions for summary judgment on the damage issue. I deferred

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exclusive territories in the beer wholesaling industry. This regulation took effect in 1979.

ruling on the motions and granted plaintiffs additional time for Bresnahan to revise his original report and correct certain admitted errors in his damage calculations.

In his second report, served on defendants in April, 1986 (referred to as "Bresnahan II"), Bresnahan completely altered the methodology employed in his original report. Rather than relying on the prices of a single Indiana distributor of A-B products for his yardstick comparison, Bresnahan obtained price data from six Indiana wholesalers, four of which are distributors of both A-B and Miller beers, and two of which distribute only Miller beers.[24] In addition, rather than performing a straightforward comparison of the prices charged by the defendants and the yardstick Indiana distributors during the relevant time period, Bresnahan compared the prices charged by the defendants in July, 1981 to prices charged by the Indiana distributors in March, 1986. After adjusting for the effect of inflation over time and higher operating costs in New Jersey, Bresnahan arrived at the following damage estimates:

Overcharge Percentage Rates			Damage Estimate ($millions)		
	A-B	Miller	A-B	Miller	Total
"High"	11.0%	9.78%	$103	$45.2	$148.2
"Middle" (Preferred Reasonable)	7.72	6.31	72.5	31.8	104.3

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[24] The four Indiana distributors of both A-B and Miller brands are Beerco, Tippecanoe Beverages, Bartholomew County Beverages and Rhoades Beverage. The two distributors which sell only Miller brands are Maco Beverages and Hamilton County Beverages.

"Low"	3.77	6.42	35.4	15.5	50.9
"Ultra-Conservative"	1.25	3.39	11.8	5.2	16

Dr. Bresnahan testified during his subsequent deposition that he "intended that part of Bresnahan I, the exact dollar figure of overcharges, in fact, to be superceded by Bresnahan II." Bresnahan Dep. Tr., 10-42. However, examination of Bresnahan uncovered numerous and substantial errors in his damage calculations. For example, Bresnahan testified that he mistakenly used the A-B overcharge rates to calculate overcharges for Miller products. The consequence of this error was that Bresnahan II overstated damages for Miller brands by $5.8 million under Bresnahan's "reasonable" overcharge estimate. Bresnahan Dep. Tr., 5.153. On another occasion, Brsnahan included the 500 case delivery prices for Miami Beverage under the single case column for overcharge calculations. Bresnahan Dep. Tr. 8.75-78. He further left many of the A-B distributor defendants' quantity discounts out of his calculations. Bresnahan Dep. Tr. 8.147-8.150. These errors also resulted in millions of dollars of overstated overcharges.

During the course of his deposition, Bresnahan submitted revised damage calculation tables on at least three occasions. Each time he redid the Miller damage calculation table at least 80% of the figures on the table changed. In one revision of the A-B damage calculation table, 88 of the 138 figures on the table were revised. In another such revision, Bresnahan introduced a new methodology -- the concept of weighing the overcharge percentages for individual packages by volume. With reference to this new approach, Bresnahan testified that "I think it's a new report." Bresnahan Dep. Tr. 9.91-92. In this "new report," Bresnahan estimated damages attributable to the A-B defendants of between $47.7 million under "reasonable" assumptions and negative $17.9 million under "ultraconservative" assumptions. Bresnahan Dep. Tr., 9.113-114. His most recent estimate of the "realistic" measure of Miller overcharges is $28.3 milion. Using "conservative" assumptions, Bresnahan concluded that the Miller defendants undercharged by $3.04 million. Thus, Bresnahan's most recent estimate of overcharges by the A-B defendants using "reasonable" assumptions is about one-third the amount originally estimated in Bresnahan I. His most recent estimate of Miller overcharges using "reasonable" assumptions is less than half of what he calculated in Bresnahan I.[25]

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[25] In his second report, Bresnahan also analyzed the prices charged by certain Indiana beer wholesalers before and after the adoption of Rule 28. He concluded from this study that the wholesale price of beer fell 12% to 16.55 following Rule 28. Plaintiffs argue that Bresnahan intended his so-called "before and after study" to serve as "a new damage calculation technique." This contention is clearly incorrect. Bresnahan offers the results of his "before and after study" only to support the general proposition that intrabrand competition has the effect of lowering prices and, conversely, that restraints on intrabrand competition enable beer wholesalers to maintain artificially high prices. Nowhere in his report or deposition testimony does he contend or even suggest that his "before and after study" of wholesale pricing in Indiana could be utilized as a reasonable methodological means of calculating the amount of damages sustained by plaintiffs as a result of restraints on intrabrand competition in New Jersey.

In view of the numerous errors which have permeated each successive revision of his damage calculations, it is extremely difficult to share Bresnahan's "high degree of confidence" in his most recent damage estimates. More importantly, however, there is at least one notable factual deficiency in Bresnahan's methodology which undermines his damage calculations. Bresnahan's assumptions relating to the "transition to competition" theory and the so-called "emerging competitive wholesaling sector" in Indiana have no support in the record.

As justification for comparing the prices charged by defendants in 1981 with the prices charged by Indiana wholesalers in 1986, Bresnahan contends that since the adoption of Rule 28 the Indiana beer wholesaling market has been undergoing a transition from a system of exclusive territories to a system of free and open competition among distributors. Under Rule 28 beer distributors anywhere in the state of Indiana can not be contractually or legally prevented from serving any retail account anywhere in the state. According to Bresnahan, Rule 28 has given rise to heightened intrabrand competition which has prompted an increasing number of wholesalers, the competitve ones, to reduce their prices in order to compete more effectively. Bresnahan argues that this process of transition to free and open intraband competition in Indiana following the banning of exclusive territories is continuing even into the present time. Thus, he contends that the full impact of Rule 28 on the wholesale pricing of beer by "competitive" distributors has not yet been felt. As a result, Bresnahan asserts that 1986 Indiana prices provide a closer approximation of the prices which would have been charged by the A-B and Miller defendants absent the alleged illegal restraints on intrabrand competition.

Bresnahan relies on his "transition to competition" theory to justify the use in his yardstick comparison of the wholesale prices of an extremely limited and select sample of Indiana distributors. As noted above, Bresnahan draws a definitive distinction between "competitive" and "noncompetitive" wholesalers in Indiana. Brsenahan argues that Indiana wholesalers were confronted with only four options:

> (1) sell only inside their APR, maintaining prices substantially above those charged by competitive wholesalers. The effect of this strategy would be steadily shrinking volume ... [and] profitability over time, as the firm will be able to continue to have sales only at those accounts which no outside competitive wholesaler seeks to serve.
>
> (2) sell only inside their APR, meeting the prices of competitive wholesalers. This ... "keep what you have" strategy ... leads to smaller profits than those that were being earned before the outbreak of competition, since volume will be about the same and gross margins will be much smaller ....
>
> (3) leave the beer distribution business.
>
> (4) grow and compete.

This choice would involve meeting the prices of competitive wholesalers, actively seeking new accounts outside the firms' APR, and building volume ... Bresnahan II at pp. 4 & 5. Bresnahan maintains that only those wholesalers who chose either the second or fourth options would be able to effectively compete in the Indiana market. He concludes that only the prices of such "competitive" wholesalers should serve as the basis for a yardstick comparison with the 1981 prices of the defendants.[26]

There is thus no dispute that Bresnahan utilized the prices charged by the lowest priced wholesalers in Indiana in his yardstick comparison. Defendants contend, and plaintiffs do not dispute, that the prevailing prices charged by so-called noncompetitive wholesalers throughout much of Indiana are higher than those of Bresnahan's "competitive wholesalers." For example, one of defendants' economic experts, Prof. Myslinski, compared the prices charged by A-B's Indianapolis distributor, B-F Beverage, with those charged by the A-B defendants during the relevant time period. He found that B-F Beverage's prices were on average no lower than the prices of the A-B defndants. Using the prices of B-F Beverages as a yardstick resulted in no damages. Myslinski Report at 94-99. Clearly, Bresnahan's choice of Indiana yardstick distributors had a dramatic effect on his damage calculations. Thus, the factual sufficiency of his damage estimates for purposes of the present summary judgment motions rests in large measure on the validity of his "transition to competition" theory.

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[26] In fact, for reasons he does not explain, Bresnahan used the March, 1986 prices of only those wholesalers who sold to accounts beyond the boundaries of their APRs. Bresnahan Dep. at 7.40:3-21.

Other than vague references to the exiting of firms from the beer wholesaling business in Indiana and the merger of these firms into surviving firms, phenomena which he concedes would be unlikely to occur if an analogue of Rule 28 were adopted in New Jersey, Bresnahan offers no facts to support his contention that the Indiana beer distribution market is undergoing a transition to competition which will result in progressively lower prices charged to retailers.[27] Bresnahan

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[27] Bresnahan's "before and after" study might arguably provide some support for his "transition to competition" theory. Bresnahan argues that this study shows that the average deflated wholesale price of A-B and Miller beer in Indiana during the period of 1979 to 1986 was 12% to 16% lower than during the period of 1971 to 1977. However, the three graphs depicting the results of his study clearly show that the average deflated price of Miller and A-B brands had been steadily declining since 1971 and that such prices actually levelled off shortly after the time Rule 28 took effect in 1979. Rather than continuing the overall trend of falling prices, the average deflated price of A-B and Miller beer remained remarkably constant between 1980 and 1986 and even increased slightly. Bresnahan II, Figures 2, 3& 4, at pp. 15-17.

Furthermore, Bresnahan made no attempt in his before and after study to control for variables other than the adoption of Rule 28, such as intensified interbrand competition possibly resulting from the introduction of new brands into the Indiana market or lowered laid-in costs of beer from the manufacturers, which might have contributed to decline in wholesale prices. Indeed, in a study of the brewing industry released in 1978, the FTC made the following observations:

> The Consumer Price Index for beer has risen at a slower rate than has the Consumer Price Index for all goods, indicating that the real price of beer has been falling over time. Again, by itself this fact does not necessarily indicate anything about competition in the industry. Costs in brewing may have risen less rapidly than the average because the industry is relatively capital-intensive and becomeing more so. However, the data on profits indicate that the industry was unable to retain the benefits of cost

assumes that only low-priced, so-called "competitive" wholesalers will prosper and grow over the long-term in Indiana. In particular, Bresnahan assumes that distributors who choose not to compete for retail accounts beyond the boundaries of their APRs or do not lower their prices to meet competition from outside wholesalers will suffer dramatically declining profits or be forced out of business. However, other than vague references to the shrinking market share of "non-competitive" wholesalers, Bresnahan once again offers no facts to support the above assumptions. He does not cite to a single "non-competitive" wholesaler whose business has been shrinking. Nor does he cite to a single wholesaler which has gone out of business since 1979 or the circumstances which contributed to its demise. Defendants on the other hand have set forth specific facts which directly refute Bresnahan's assumptions regarding the alleged "transition to competition."

The "competitive" wholesalers upon whose prices Bresnahan relies in his report have not taken over the marketplace as Bresnahan's theory predicts. Out of approximately 57 A-B distributors in Indiana, Bresnahan concedes that only

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> reductions for itself (relative to the average for all products); thus, the implication is that competition forced any savings in cost to be passed on to consumers.

Bureau of Economics, Federal Trade Commission, The Brewing Industry at 3 (1978).

I conclude that Brèsnahan's before and after study does not provide a factual basis for his "transition to competiton" theory.

between six and twelve of them fit his narrow definition of a "competitive" wholesaler. Bresnahan Dep. Tr. at 11.138. Thus, the vast majority of wholesalers in Indiana have opted to refrain from selling to retail accounts located outside their APRs and have presumably maintained higher prices notwithstanding the risk of competition from lower-priced wholesalers outside their APRs. Nevertheless, over seven years after the enactment of Rule 28 these so-called "non-competitive" wholesalers have continued to survive and sell to retailers in markets which Bresnahan himself describes as competitive. For example, Bresnahan states in his report that Indianapolis is a "competitive market." Bresnahan II at 6. He further testified during his deposition that the "competitive" wholesalers whose prices he utilized in his yardstick analysis sell to retail accounts located in Indianapolis. However, Bresnahan maintains that it is not appropriate to use the prices charged by B-F Beverage, which is actually located in Indianapolis, because B-F Beverage does not fit his definition of "competitive." Bresnahan II at pp. 57-58.

In addition, there is evidence that the competitive wholesalers that Bresnáhan utilized in his yardstick analysis have not been capturing ever-increasing shares of the Indiana market. As one of defendants' economic experts points out in his report:

> Professor Bresnahan's transition argument is contradicted further by the fact that the share of his "competitive" distributors has not increased over the 1981 to 1985 period. Indeed, when I calculate the combined share of Tippecanoe, Miami and Rhoades over the 1981 and 1985 period, I find that their share of

> beer sales in Indiana dropped from 17.4% to 15.5%. Thus, the data do not indicate a "transition to competition which is not yet complete."

Hausman Report at 29. In the short time since Bresnahan completed Bresnahan II, two of the six Indiana wholesalers utilized in his yardstick analysis have gone out of business having sold out to other firms. One such wholesaler, Hamilton County Beverages, reportedly sold out because it was not making money. Linneman Affidavit, ¶ 8. Indeed, Bresnahan admitted that each of the "competitive" Indiana distributors used in his yardstick analysis had been forced to restrict the areas in which they were attempting to compete:

> Q. Now the geographic area that is actually served by these competitive wholesalers is shrinking isn't it, by any given one of them; they're retrenching. They're not selling to as many accounts as far away from their warehouse as they used to; right?
>
> A. Right.

Bresnahan Dep. Tr. at 12.24.

The above evidence suggests that the efforts of Bresnahan's so-called "competitive" wholesalers to penetrate markets outside their assigned APRs merely by charging lower prices has not brought about results consistent with his "transition to competition" theory. Rather, price does not appear to be the primary determinant of the long-term success or failure of beer wholesalers, as Bresnahan argues. Instead, there must be factors other than price, such as superior service, which are influencing Indiana retailers to continue buying from allegedly higher priced wholesalers and which Bresnahan has not taken into account in his yardstick analysis. More importantly, the above evidence suggests that the decision of the vast majority of Indiana distributors to concentrate their sales and merchandizing activity within their APRs and to refrain from reducing their prices to meet outside competition represents an efficient and competitive response to the wholesale beer market in Indiana following the adoption of Rule 28. Thus, Bresnahan's assumption that absent restraints on intrabrand competition the prices charged by the defendants in 1981 would have resembled the deflated prices charged by his yardstick Indiana wholesalers in 1986 appears to be entirely without factual basis.

Bresnahan has not provided a factually supported rationale for limiting the yardstick to the prices of just six of the "competitive" wholesalers and for excluding from his yardstick comparison the prices of the other "competitive" wholesalers and of all the so-called "non-competitive" wholesalers. Thus his computation of damages lacks a foundation.

Defendants advance a number of other grounds to attack Bresnahan's conclusions: (i) he failed to show that the firms and markets selected as yardstick are comparible to the allegedly restrained firms or markets except for the effect of the alleged antitrust violation. (see Bresnahan Dep. Tr. 7.127-135); (ii) he failed to take into account major cost differences between the Indiana and New Jersey wholesale beer distribution markets, e.g., labor costs and non-labor costs such as insurances and cost of capital; (iii) Bresnahan failed to adjust for other significant differences between the wholesale operations of Indiana "competitive" wholesalers and those of the wholesalers in New Jersey, such as different service levels and different regulatory constraints; (iv) Bresnahan improperly used the March 1986 prices as his yardstick because use of a one month period for a four year damage estimate is an unaccepted econometric practice (i.e., provides no basis for a reasonable inference); (v) Bresnahan's use of the GNP deflator was not a reasonable basis to account for inflation in beer wholesaler costs since he had available a deflator applicable to a beer distributor's costs.

Certain of these contentions present no material issues of fact. Others involve disputes between the parties' expert witnesses and in other ways do present material factual issues. However, in view of the conclusion that the selection of prices charged by the so-called "competitive" wholesalers as the foundation for the damages competition did not have a rational basis, it is unnecessary to analyze each of their other contentions.

I conclude, therefore, that defendants are entitled to summary judgment on the issue of damages.

In the discussion of proof of impact in Section VB above, I concluded that plaintiffs' claim of antitrust impact must rise or fall on the validity of Bresnahan's yardstick analysis. Having found that the yardstick analysis lacks a rational foundation, it follows that plaintiffs have failed to adduce evidence on the basis of which antitrust impact could be found.

VI. CONCLUSION

Defendants are entitled to summary judgment in their favor on the issues of conspiracy, antitrust impact and damages. It is unnecessary to address the alternative motion for class decertification. Defendants' attorneys are requested to present an appropriate form of order.

DICKINSON R. DEBEVOISE, U.S.D.J.

October 19, 1987

Attachment 3

beer marketer's
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Whoopee! NJ Wholesalers, AB and Miller Won Summary Judgment in Big Antitrust Suit

You couldn't ask for a more comprehensive and well thought-out decision supporting wholesaler territories. On every count, every which way you look at it, a US District Court knocked out, in one magnificent 148-page summary judgment, an absurd effort by retailers to get money from wholesalers and brewers on the ground they conspired to eliminate competition by fixing territories, causing wholesale prices of beer to rise to artificially high levels. Whatever they alleged, the judge found their arguments lacking in fact and/or logic. Judge didn't mince words about the flimsiness of these charges. Here is just a sampling of his powerful denunciations of these arguments: "Extremely thin," "extraordinarily weak," "particularly pronounced deficiencies," "desperate effort," "rank speculation," "weak to non-existent," and (our favorite) "an evidentiary vacuum." And, remember, before he issues summary judgment, judge has to look at inferences in most favorable light for plaintiffs. And so, after an estimated $3 million legal expense by brewers and NJ wholesalers, without aid from anyone, everyone is breathing a lot easier. While he acknowledged wholesaler territories are legal, judge found no conspiracy, no antitrust violation and no triple damages.

The suit was started in 1983 by retailers who had just won a $900,000 settlement with Seagram's, and thought they could use most of that as legal fees to blast money out of beer wholesalers and brewers. (We hear they used it all, that attys then were on their own.) At first sued brewers and 26 distributors. But judge stopped that, and case was finally only against AB and Miller wholesalers and AB and Miller. The conspiracies, plaintiffs argued, occurred before AB and Miller equity agreements of 82 and 83 and when contracts in effect were written under Schwinn decision prohibiting mandated territories. Later, the plaintiffs claimed, the conspiracy continued. The judge kicked it all out.

Positive Implications of NJ Decision on NY Case and for MBICA; Gellhorn Calls It Helpful

This sweeping decision has important implications. The NY case by Atty Gen Abrams and others against distribs has developed along similar lines, and will hopefully meet similar results. Ernest Gellhorn, wholesalers counsel in the NY case, called the decision "extraordinarily helpful," adding "the parallels are striking" between the NY and NJ cases. He also said: "This is a careful, rigorous, thoughtful analysis by an outstanding judge and gives us great hope." He also notes: "The court blew out of the water some of the major arguments made by Abrams and others against MBICA." Specifically, the court found no evidence of price-fixing and did not conclude that territorial agreements decreased competition. These are 2 of the same charges made in NY suits. Quite possibly the decision can be used in Congress to help pass MBICA.

Wholesalers Used Sound Business Judgment As They Followed Brewer Directions On APRs

Judge showed insight into problems of daily decisions each wholesaler faces. When he looked at possibility of horizontal conspiracy among wholesalers, he asked whether it was possible that each wholesaler had reason to make independent decisions and come to same conclusion. Despite different legal arguments by AB and Miller groups--AB guys saying they sold only in territories, and some Miller guys saying they sold outside ter-

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ritory--all argued they followed corporate policies of not selling outside their areas. Did so because maintaining good relations with brewers was critical to their survival. Each wholesaler recognized the brewers had many ways of destroying a business, "including withholding credit, restricting a distributor's allocation of beer," dualing, terminating, etc. As a result, each made "separate and independent business judgment that the short term-profits, if any" to be derived from sales outside Area of Primary Responsibility not worth while. So, the judge decided, "constraints on intrabrand competition were the result of vertical direction from the brewers." Besides, there was no evidence of meetings, telephone calls, or correspondence to fix prices or territories.

But was fear of brewer sanctions a credible justification for not selling outside APRs? Studying AB wholesalers first, judge said these fears had to be grounded "in belief that AB might contrive alternative reasons for imposing sanctions." Noted the 1974 AB contract really didn't protect wholesalers as "AB had considerable latitude to find fault, or withhold at its discretion certain assistance,... including credit,... and sharing the cost of promotional activities." So, as even a plaintiff expert agreed, selling only in APR was a "rational business decision even if the risk of termination... was relatively slight.... The motive to enter a horizontal conspiracy was at best no greater than the motive to continue adhering to the policy of AB."

Two other questions: why didn't AB wholesalers sell to co-ops and why weren't territories realigned for greater efficiency serving co-ops. Judge pointed to fact that "AB encouraged distributors to invest the time, energy and resources necessary to develop and maintain good will of retailers" in their territories, and that periodic realignment discourages wholesaler reinvestment. So he also said: "exchange of beer at cost, selective sales abstention and convenience sales... is entirely consistent with vertically directed territorial exclusivity." And AB wholesalers didn't sell to co-ops.

Since Some Miller Guys Transshipped Sometimes, No Conspiracy, Said Judge

What about Miller guys? Some transshipped. One sold more than 14% of Miller volume outside its APR one year. The judge saw this as "intrabrand competition." One wholesaler had objected to sales of another in his territory. That was evidence of no horizontal conspiracy. And one Miller wholesaler said he'd sell to co-ops, meet the competition. That, the judge said, "is indicative of some degree of intrabrand competition." Besides there was no consistent or continuous pattern of selling outside an APR.

But retailers alleged they couldn't buy beer except from the exclusive distributor in the area, that Miller sales outside APRs were tiny % of sales. Fact that one guy made so many sales outside APR made this claim invalid, judge said. Plaintiffs also argued that wholesalers acted against their economic interests by not selling outside APRs. So judge looked at deposition of veep Lennie Goldstein who testified that Miller had longstanding preference that its designated distributors confine sales to assigned territories. Judge noted: "Tho Miller was generally more cautious than AB in its efforts to communicate this policy.... Miller was not only less insistent...; communications ... were more equivocal in nature." Still, "Miller defendants had ample reason to believe that a poor performance rating...could result in termination." And "the disparate behavior of the Miller defendants is precisely what would be expected of independent businesses making independent decisions in accordance with their economic interests."

Still one more charge: that Miller and AB wholesalers had market power to raise price and did so. Judge noted that in the period Miller brands slid from 21.1% to 17.3% of Jersey while AB up from 45 to 48.5%. It was unlikely, the judge said, "that AB could have captured progressively larger shares... if its distributors were simultaneously setting the prices... above competitive levels." Similarly, it was "unlikely that Miller defendants would have followed non-competitive price increases in AB brands ... when market share of Miller brands was declining."

You Gotta Read Some Wholesaler Quotes and Judge's Comments About Indiana

While the judge noted fears of AB and Miller wholesalers that they could be terminated if they didn't follow corporate policy on APRs, he had interesting quotes only from Miller wholesalers. Here are some: "Miller often found reason to be critical." "They'll sit and tell you that... we feel that you should have another sales manager,... additional trucks,... new warehouse,..another merchandising mgr." "Whenever the wholesaler would react to the criticisms,...further criticisms would develop." "I was always concerned that if Miller wanted to find something wrong it could do so by letting the rating slip in one or two areas." The judge noted that Miller was "the final arbiter" as to whether Miller wholesalers "were satisfying these vague contractual requirements." The judge also devoted many pages to a study of Indiana and wrote that the prices of AB Indianapolis distributor "were on average no lower than the prices of" AB wholesalers in NJ, that most Ind distribs did not sell outside their APRs, that they still survive, while transshippers "have not increased market share and have been forced to restrict the areas in which they were attempting to compete." As result, he said, "price does not appear to be the primary determinant of the long-term success of beer wholesalers."

THIS CASE IS SO INTERESTING THAT WE KNOW MANY WILL WANT TO READ IT. We're therefore making this 148-page case, plus a 4-page Beer Marketer's INSIGHTS synopsis, available to anyone who wants it for $60. There are so many details in the case, and great quotes, that you'll have fun reading it. JUST SEND IN ORDER WITH $60, and you'll get it PRONTO. The case is better reading than a lot of books.

AB Up 3 Mil Bbls, Industry Up Slightly as Miller, Coors Up Slightly Too; Others Down

Since AB announced 580,000-bbl, 3% gain in 3d qtr, and Beer Institute veep Phil Katz estimates domestic shipments flat for 3d qtr and 9 mos, it's now possible to come up with estimates of how top brewers did for the qtr and thru Sep. Since AB gained 3 mil bbls, 5% for 9 mos, and domestic industry up very little, means other US brewers lost nearly 3 mil bbls, 2% during same period. Philip Morris announced Miller off slightly in 3d qtr. We estimate 50,000-bbl drop. For 9 mos, Miller up about 200,000 bbls, less than 1%. Stroh improved with 75,000-bbl, 1% drop in 3d qtr (compared to revised number for 3d qtr 86), but still down an estimated 925,000 bbls, 5% for 9 mos. Heileman also improved somewhat in 3d qtr, but still off about 225,000 bbls, 5%, adjusting to include Schmidt and Champale volume. That means Heileman off 1.1 mil bbls, 8.5% for 9 mos. Coors up about 100,000 bbls, 3% for 3d qtr. While Coors up nearly 300,000 bbls for 9 mos nationwide, it undoubtedly shipped more than that to NY-NJ. So Coors lost ground outside of expansion. Meanwhile, we estimate Pabst down 800,000 bbls, 14% for 9 mos. All Other domestic brewers dropped about 400,000 bbls, 6% for 9 mos. Note too that even amidst talk of Corona slowdown, Corona gained more than twice as much for 9 mos as any brewer besides AB. All in all, taxpaid and imported shipments up estimated 300,000 bbls, 0.2% thru Sep.

All figures except AB's are BMI estimates.)

	3d Qtr (add 000)		Chg	9 Mos (000)		Chg
	1987	1986	%	1987	1986	%
AB	19,980	19,405	3.0	58,486	55,493	5.4
Miller	10,550	10,600	-0.5	30,420	30,200	0.7
Stroh	5,750	5,825	-1.3	16,050	17,775	-5.2
Heileman	4,300	4,525*	-5.0	12,100	13,225*	-8.5
Coors	4,100	3,980	3.0	12,100	11,830	2.3
Pabst	1,430	1,650	-13.3	4,860	5,650	-14.0
All Others	2,100	2,284	-8.1	6,588	7,006	-6.0
Domestic	48,210	48,269	-0.1	141,404	141,179	0.2

(*Adjusted to include estimates for Champale for all of 86, C Schmidt for Jun-Sep 86.)

AB Told Wall St Most Brands Up Strongly; Analysts Disagree on Amount of '88 Price Increase

When AB group veep Jerry Ritter met with financial analysts on Oct 30, he said Bud up 3%, Bud Light up 18-20%, Busch up double-digits, Michelob down 4%, Mich Light up 2% and Natural Light up double-digits, according to Larry Pidgeon of Goldman Sachs. Manny Goldman of Montgomery Securities reports that Bud up more than 3% outside of NY-NJ (where Coors intro'd), Tex (where economy clobbered) and Calif (where AB share 50% with no Busch). Manny wrote: "Bud will pay special attention to those markets next year." So Bud brand still grew while not having as good a year in 3 biggest states. Bud has over 35% of Hispanic market. Manny wrote Bud Light passed Coors Light for #2 position in segment. At this rate, will be 3d straight 1-mil-bbl-plus gain for Bud Light. Busch is "the number one selling low-priced brand," wrote Manny. (Editor's Note: In 87, Bud Light, Coors Light and Busch volume each will surpass Old Milwaukee.) Larry Pidgeon reports that AB costs "flat to down slightly." Tho Joe Frazzano at Oppenheimer had earlier reported AB prices will go up 3-4% next yr, Larry expects around a 2% increase. Manny expects even less: "Bud will clearly put in place only enough price to permit the company to satisfy its own volume and earnings objectives, even if this means that the company will raise prices only one percent." Other interesting info: Larry points out that AB coming on in Chicago; share up from 10% to 15%. AB testing 4 new products, including a no-alcohol beer. Meanwhile, after string of non-successes in Beverage Group, AB "reevaluating," said Larry. AB will have 82-mil-bbl capacity in 88.

A Sense of Solidarity Among Fla Wholesalers Still in Assn; Unusual State Meeting

You knew this state convention had to be different. Since Fla wholesalers passed extremely controversial franchise bill earlier this year, most AB wholesalers dropped out of the assn and formed their own. Then Miller sales veep Tom Koehler wrote Fla assn exec Buddy Gridley (copying all Miller Fla distribs) declining to participate in convention because of franchise law. Tom wrote: "We are unwilling to support state wholesaler groups who deem it necessary to unilaterally alter the business relationship we have sought to create, by passing such 'protectionist' legislation.... Your new law will force our relationship to be rigid and inflexible, instead of cooperative." Tom also wrote: "We have recently seen... signs that our unified efforts... our partnership is beginning to deteriorate." ....Fla wholesalers gave Buddy Gridley a standing ovation for getting bill passed. Then NBWA prexy Ron Rumbaugh told Fla wholesalers: "I'm so proud of this man" and called passage of bill "an almost impossible feat" and "absolutely spectacular." While Miller Brewing didn't show up, most Miller wholesalers did. Several AB wholesalers still in assn attended. In striking contrast to AB and Miller, Coors threw a party for all Fla wholesalers and even served competitors' products. Prexy Pete Coors flew from Shenandoah opening same day, adding clout to widely applauded move. Coors sales veep Gary Truitt told INSIGHTS that Coors too objects to certain aspects of Fla franchise bill as "unilateral and unfair." But he said: "I don't think our position is that different from AB or Miller. Our reaction is. The Florida situation is done. We can't forsake our business relationships. If we have a problem with our wholesalers, we have to sit down and work it out together."

MBICA Markup in Senate Subcommittee Expected Very Soon, Said Ron Rumbaugh

On Oct 26, NBWA prexy Ron Rumbaugh told Fla wholesalers: "We anticipate... that the markup in subcommittee will occur within the next couple of weeks." Then MBICA "will pass through the full committee. Then a decision has to be made." Decision whether to push forward this year or wait till early next year and beginning of 2d session of 100th Congress. Ron "more comfort[illegible] 'we have greater margin" on full judiciary committee. He added: "I'm encour[illegible] that even with almost total odds... we have moved and will move the bill [illegible] floor of the United States Senate." There Ron pointed out "each [illegible] will be a critical vote," because 60 votes are needed to prevent fili[illegible].

The 21st Amendment Got a Boost, But Will It Hold??? Brewers Don't Like This One

When US Dist Ct in Connecticut reviewed [illegible] suit that sought to stop 2d affirmation law passed in Conn, ruled in Sep that state could enact this law under 21st amendment, and that this law doesn't interfere [illegible] commerce [illegible] plea for those who support broad states rights under the 21st amendment. But [illegible] bet no brewer liked the decision which will be appealed. The affirmation law [illegible] that prices in Conn must be as low as those in neighboring states. Brewers argued the law interfered with the prices of brewers in neighboring states. Despite the Conn law, the court said: "Brewers and importers are free to raise or lower their prices in the border states." Judge reasoned that holding the affirmation law constitutional "comports with the spirit of the 21st amendment, which was intended to return broad control of the liquor industry to the states." He also said: "Such a finding is consistent with the Supreme Court's interpretation of the commerce clause as it has evolved to date."

Best wishes, Jerry

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